INSERT TAB 200

FAIR LENDING

Introduction

The Office of Thrift Supervision's nondiscrimination regulations for lending are found in § 528. These requirements were adopted in furtherance of the Federal civil rights laws and economical home financing purposes of the statutes administered by the agency. The nondiscrimination regulations prohibit, among other things, refusals to consider loan applications on the basis of the age or location of a dwelling, and discrimination based on race, color, religion, sex, handicap, familial status or national origin, in fixing the amount, interest rate, duration, application procedures, collection or enforcement procedures, or other terms or conditions of housing related loans. These rules operate in addition to the provisions of the Equal Credit Opportunity Act and its implementing Federal Reserve Board Regulation B, and the Fair Housing Act.

Nondiscrimination in Lending and Other Services

As stated in § 528.2, no savings association may deny a loan or other service, discriminate in the purchase of loans or securities, or discriminate in fixing the amount, interest rate, duration, application procedures, collection or enforcement procedures, or other terms or conditions of a loan or other service on the basis of the age or location of the dwelling, or on the basis of the race, color, religion, sex, handicap, familial status or national origin of:

- an applicant or joint applicant;
- any person associated with the applicant regarding such loan or other service, or with the purposes of such loan or other service;
- the present or prospective owners, lessees, ten ants, or occupants of the dwelling(s), or other dwellings in the vicinity of the dwelling(s) for which such loan or other service is to be made or given; and
- the present or prospective owners, lessees, ten ants, or occupants of other dwelling(s), for which such loan or other service is to be made or given.

An association must consider, without prejudice, the combined income of joint applicants for a loan or other service. The practice of discounting all or a part of either spouses' income where spouses apply jointly is a violation of the National Housing Act. As with other income, when spouses apply jointly for a loan, the determination as to whether a spouse's in come qualifies for credit purposes should depend upon a reasonable evaluation of his or her past, present, and reasonably foreseeable economic circumstances. Information relating to childbearing intentions of a couple or an individual may not be requested.

The OTS nondiscrimination regulations are specifically applicable to loan applications by American Indians, and to loans secured by property located on or in the vicinity of an American Indian Reservation.

Nondiscriminatory Appraisal and Underwriting

Appraisals

Associations are prohibited by § 528.2a from using or relying upon an appraisal of a dwelling which it knows, or reasonably should know, is discriminatory on the basis of the age or location of the dwelling, or is discriminatory per se or in effect under the Fair Housing Act or the Equal Credit Opportunity Act.

Loan decisions should be based on the present market value of the property offered as security (including consideration of specific improvements to be made by the borrower) and the likelihood that the property will retain an adequate value over the term of the loan. Specific factors which may negatively affect its short range future value (up to 3-5 years) should be clearly documented. Factors which in some cases may cause the market value of a property to decline are recent zoning changes or a significant number of abandoned homes in the immediate vicinity of the property. However, not all zoning changes will cause a decline in property values, and proximity to abandoned buildings may not affect the market value of a property because of re habilitation programs or affirmative lending programs, or because the cause of abandonment is unrelated to risk. An appraisal standard is one of several critical components of a sound underwriting policy. The savings association's written appraisal policy and practices, should provide for nondiscriminatory assessments of market conditions and estimates of market value. Management should include these considerations in its periodic review of the performance of approved appraisers.

Underwriting

Each association is required to have clearly written, nondiscriminatory loan underwriting standards available to the public upon request, at each of its offices. These standards must be annually reviewed by the association to ensure equal opportunity in lending. The use of lending standards which have no economic basis and which are discriminatory in effect is a violation of law even in the absence of an actual intent to discriminate. However, a standard which has a discriminatory effect is not unnecessarily improper if its use achieves a genuine business need which cannot be achieved by means which are not discriminatory in effect or less discriminatory in effect.

Proper underwriting considerations include the conditions and utility of the improvements, and various physical factors such as street conditions, amenities such as parks and recreation areas, availability of public utilities and municipal services, and exposure to flooding and land faults. However, arbitrary decisions based on age or location are prohibited, since many older, soundly constructed homes provide housing opportunities which may be precluded by an arbitrary lending policy.

Perceived negative property features should be based upon sound economic principals, fully supported, and may not be double counted in the appraisal and underwriting process.

The FHLBB previously acknowledged that one valid reason for denying a loan would be a savings association's inability to enforce its security interest following default if there was a lack of a judicial or quasijudicial process to do so in an area under the jurisdiction of an American Indian tribe. An association defending such a policy or practice as a bona fide business necessity must demonstrate that there is "no reasonable forum" provided by the tribal court system for the enforcement of its security interest. The following considerations apply:

- If a tribal court or other adjudicatory system provides remedies similar or identical to those available in state courts, there would be a conclusive presumption that a reasonable forum exists.
- If the lender can effectively recover the collateral, then a tribal system would constitute a reasonable forum, even if it differs from a state forum.
- An argument that the tribal process would be time consuming or too costly will not meet the "no reasonable forum" standard, unless specific statistical evidence is shown that the chances of cost-effective recovery, i.e., as related to the recoverable value of the security interest, are smaller than the chances under state law.
- If an association intends to offer as a reason for denial that a tribal legal system is inadequate, it must consult legal counsel. Prior to the association's denial of any loan application on this basis, management must obtain counsel's written opinion concluding that no reasonable forum exists in the tribal court system to allow the enforcement of a security interest. That opinion should be maintained as part of the file for each affected loan application.

Nondiscrimination in Applications

Associations are prohibited from discriminating on a prohibited basis against anyone who: makes application for any such loan or service; requests forms or papers to be used to make application for any such loan or service; or inquires about the availability of such loan or service.

Anyone inquiring about a loan has a right to file a written application and to receive a copy of the association's underwriting standards. Each association has to inform inquirers of this right.

Nondiscriminatory Advertising

No association may directly or indirectly engage in any form of advertising which implies or suggests a policy of discrimination or exclusion in violation of Title VIII of the Civil Rights Act of 1968, the Equal Credit Opportunity Act, or the OTS nondiscrimination requirements. Advertisements other than for savings shall include a facsimile of the Equal Housing Lender logotype and legend.

Associations should review their advertising and marketing practices to ensure that their services are available without discrimination to the community they serve. Discrimination in lending is not limited to loan decisions and underwriting standards; an association does not meet its obligations to the community or implement its equal lending responsibility if its marketing practices and business relationships with developers and real estate brokers improperly restrict its clientele to segments of the community. This review should begin with an examination of the loan portfolio and applications to as certain whether, in view of the demographic characteristics and credit demands of the community in which the association is located, it is adequately serving the community on a nondiscriminatory basis.

Equal Housing Lender Poster

Section 528.5 requires each association to post and maintain an Equal Housing Lender Poster in the lobby of each of its offices in a prominent place(s) readily apparent to all persons seeking loans. This section also mandates the text of the poster.

Loan/Application Registers

Savings associations subject to Federal Reserve Board Regulation C are required to maintain loan application registers and file those registers with the OTS in accordance with 12 CFR 203. In addition, savings associations must enter the reason for denial, using the codes in 12 CFR 203 for all loan denials.

Examination Objectives

To assure that the association is not discriminating on a prohibited basis in the loan decision-making process.

To assure that the association has procedures in place to assure that it is in compliance with the non discrimination requirements.

To assure that the association is properly completing its loan/application registers.

To aid the Community Reinvestment Act examination by determining within the assessment area, the distribution of applications received from and loans made in the community, including low/ moderate income census tracts and in determining whether there are sections of the CRA community or effective lending territory in which the association is not an active lender.

Examination Procedures

On December 4, 1998, the Federal Financial Institutions Examination Council approved new Interagency Fair Lending Examination Procedures. OTS implemented these procedures effective for all examinations commencing March 1, 1999 or after. These procedures are set forth in Section 201 of this handbook.

Interagency Fair Lending Examination Procedures are designed to identify and document fair lending violations and compliance management deficiencies through a file analysis regimen. They represent a flexible framework for conducting an analysis of whether credit decisions are discriminatory in violation of the Fair Housing Act and the Equal Credit Opportunity Act. These procedures are to be integrated with the compliance examination program in an efficient and effective manner to assure appropriate oversight of all fair lending statutory and regulatory requirements in keeping with OTS' risk-focused, top-down approach.

Examiners should review the content and accuracy of the HMDA registers to ensure that the data reported is correct and can provide an appropriate basis for scoping the fair lending examination. The

HMDA review should be guided by the procedures contained in Section 205 of this handbook.

Examiners should conduct the fair lending examination by following the Interagency Fair Lending Examination Procedures set forth in Section 201 implemented in accordance with training and other agency guidance. During the examination, the examiner should also consider the institution's compliance with nondiscrimination obligations imposed by OTS regulations and the technical requirements of other applicable federal nondiscrimination laws and regulations.

References

Laws

Civil Rights Act of 1964

42 USC 3601 et seq.	Title VIII of the Civil Rights Act of 1968-Fair Housing Act
42 USC Section 901	Title IX of the Civil Rights Act of 1968-Prevention of Intimidation in Fair Housing
15 USC 1691 et seq.	Equal Credit Opportunity Act
12 USC 2801 et seq.	Home Mortgage Disclosure Act
2 USC 2901 et seq.	Community Reinvestment Act of 1977

Regulations

24 CFR 109	Fair Housing Advertising Regulation
12 CFR 202	Regulation B
12 CFR 203	Regulation C
12 CFR 528	Nondiscrimination Requirements: Nondiscrimination in Lending and Other Services Nondiscriminatory Appraisals and Underwriting Nondiscrimination in Applications Nondiscriminatory Advertising Equal Housing Lender Poster Monitoring Information—Loan Application Register Nondiscrimination in Employment Complaints
12 CFR 563e	Community Reinvestment

Memoranda, Resolutions, and Opinions

SP 15	Enforcement Guidelines for Violations of the OTS' Nondiscrimination Regulations
R 30b	Fair Housing Logos and Legends. Useful Guidelines for Sizing Logos and Legends; However, Alternative Use of "Equal Opportunity Lender" Legend Is No Longer Valid
TB 19	Revised HUD Fair Housing Regulations
TB 25	Disparities in Mortgage Lending
TB 40	Regulation B Amended to Implement the Women's Business Ownership Act of 1988
FHLBB Resolution 78-302	Published in the Supervisory Service as Comment-Ruling at 11,041. Prohibitions Against Discrimination in Financing of Housing

OGC Opinion 03/21/74	Published in the Supervisory Service as Comment-Ruling at 11,039. Applicability of Part 528 to 'Redlining', and 'Discrimination in Effect' and the Association's Burden of Proof. (See annotation .2 to 12 CFR 528.2a)

Other References

FFIEC Pamphlet	Home Mortgage Lending and Equal Treatment

Overview of Fair Lending Laws and Regulations

This overview provides a basic and abbreviated discussion of federal fair lending laws and regulations. It is adapted from the Interagency Policy Statement on Fair Lending issued in March 1994.

1. Lending Discrimination Statutes and Regulations

- The Equal Credit Opportunity Act (ECOA) prohibits discrimination in any aspect of a credit transaction. It applies to any extension of credit, including extensions of credit to small businesses, corporations, partnerships, and trusts.

The ECOA prohibits discrimination based on:

- Race or color
- Religion
- National origin
- Sex
- Marital status
- Age (provided the applicant has the capacity to contract)
- The applicant's receipt of income derived from any public assistance program
- The applicant's exercise, in good faith, of any right under the Consumer Credit Protection Act.

The Federal Reserve Board's Regulation B, found at 12 CFR part 202, implements the ECOA. Regulation B describes lending acts and practices that are specifically prohibited, permitted, or required. Official staff interpretations of the regulation are found in Supplement I to 12 CFR part 202.

The Fair Housing Act (FH Act) prohibits discrimination in all aspects of "residential real-estate related transactions," including but not limited to:

- Making loans to buy, build, repair or improve a dwelling
- Purchasing real estate loans
- Selling, brokering, or appraising residential real estate
- Selling or renting a dwelling.

The FH Act prohibits discrimination based on:

- Race or color
- National origin
- Religion
- Sex
- Familial status (defined as children under the age of 18 living with a parent or legal custodian, pregnant women, and people securing custody of children under 18)
- Handicap.

HUD's regulations implementing the FH Act are found at 24 CFR Part 100.

Because both the FH Act and the ECOA apply to mortgage lending, lenders may not discriminate in mortgage lending based on any of the prohibited factors in either list.

Under the ECOA, it is unlawful for a lender to discriminate on a prohibited basis in any aspect of a credit transaction, and under both the ECOA and the FH Act, it is unlawful for a lender to discriminate on a prohibited basis in a residential real-estate-related transaction. Under one or both of

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these laws, a lender may not, because of a prohibited factor:

- Fail to provide information or services or provide different information or services regarding any aspect of the lending process, including credit availability, application procedures, or lending standards
- Discourage or selectively encourage applicants with respect to inquiries about or applications for credit
- Refuse to extend credit or use different standards in determining whether to extend credit
- Vary the terms of credit offered, including the amount, interest rate, duration, or type of loan
- Use different standards to evaluate collateral
- Treat a borrower differently in servicing a loan or invoking default remedies
- Use different standards for pooling or packaging a loan in the secondary market.

A lender may not express, orally or in writing, a preference based on prohibited factors or indicate that it will treat applicants differently on a prohibited basis.

A lender may not discriminate on a prohibited basis because of the characteristics of

- An applicant, prospective applicant, or borrower
- A person associated with an applicant, prospective applicant, or borrower (for example, a co-applicant, spouse, business partner, or live-in aide)
- The present or prospective occupants of either the property to be financed or the neighborhood or other area where property to be financed is located.

Finally, the FH Act requires lenders to make reasonable accommodations for a person with disabilities when such accommodations are necessary to afford the person an equal opportunity to apply for credit.

2. Types of Lending Discrimination

The courts have recognized three methods of proof of lending discrimination under the ECOA and the FH Act:

- Overt evidence of disparate treatment
- Comparative evidence of disparate treatment
- Evidence of disparate impact.

Disparate Treatment

The existence of illegal disparate treatment may be established either by statements revealing that a lender explicitly considered prohibited factors (**overt** evidence) or by differences in treatment that are not fully explained by legitimate nondiscriminatory factors (**comparative** evidence).

Overt Evidence of Disparate Treatment. There is overt evidence of discrimination when a lender openly discriminates on a prohibited basis.

Example: A lender offered a credit card with a limit of up to $750 for applicants aged 21-30 and $1500 for applicants over 30. This policy violated the ECOA's prohibition on discrimination based on age.

There is overt evidence of discrimination even when a lender expresses - but does not act on - a discriminatory preference:

Example: A lending officer told a customer, "We do not like to make home mortgages to Native Americans, but the law says we cannot discriminate and we have to comply with the law." This statement violated the FH Act's prohibition on statements expressing a discriminatory preference as well as Section 202.5(a) of Regulation B, which prohibits discouraging applicants on a prohibited basis.

Comparative Evidence of Disparate Treatment. Disparate treatment occurs when a lender treats a credit applicant differently based on one of the prohibited bases. It does not require any showing that the treatment was motivated by prejudice or a conscious intention to discriminate against a person beyond the difference in treatment itself. It is considered by courts to be intentional discrimination because no credible, nondiscriminatory reason explains the difference in treatment on a prohibited basis.

Disparate treatment may more likely occur in the treatment of applicants who are neither clearly well-qualified nor clearly unqualified. Discrimination may more readily affect applicants in this middle group for two reasons. First, if the applications are "close cases," there is more room and need for lender discretion. Second, whether or not an applicant qualifies may depend on the level of assistance the lender provides the applicant in completing an application. The lender may, for example, propose solutions to credit or other problems regarding an application, identify compensating factors, and provide encouragement to the applicant. Lenders are under no obligation to provide such assistance, but to the extent that they do, the assistance must be provided in a nondiscriminatory way.

<u>Example</u>: A nonminority couple applied for an automobile loan. The lender found adverse information in the couple's credit report. The lender discussed the credit report with them and determined that the adverse information, a judgment against the couple, was incorrect since the judgment had been vacated. The nonminority couple was granted their loan. A minority couple applied for a similar loan with the same lender. Upon discovering adverse information in the minority couple's credit report, the lender denied the loan application on the basis of the adverse information without giving the couple an opportunity to discuss the report.

The foregoing is an example of disparate treatment of similarly situated applicants, apparently based on a prohibited factor, in the amount of assistance and information the lender provided.

If a lender has apparently treated similar applicants differently on the basis of a prohibited factor, it must provide an explanation for the difference in treatment. If the lender's explanation is found to be not credible, the agency may find that the lender intentionally discriminated.

<u>Redlining</u> is a form of illegal disparate treatment in which a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located. Redlining may violate both the FH Act and the ECOA.

Disparate Impact

When a lender applies a racially or otherwise neutral policy or practice equally to all credit applicants, but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis, the policy or practice is described as having a "disparate impact."

<u>Example</u>: A lender's policy is not to extend loans for single family residences for less than $60,000.00. This policy has been in effect for ten years. This minimum loan amount policy is shown to disproportionately exclude potential minority applicants from consideration because of their income levels or the value of the houses in the areas in which they live.

Although the precise contours of the law on disparate impact as it applies to lending discrimination are under development, it has been clearly established the single fact that a policy or practice creates a disparity on a prohibited basis is not alone proof of a violation.

When an Agency finds that a lender's policy or practice has a disparate impact, the next step is to seek to determine whether the policy or practice is justified by "business necessity." The justification must be manifest and may not be hypothetical or speculative. Factors that may be relevant to the justification could include cost and profitability. Even if a policy or practice that has a disparate impact on a prohibited basis can be justified by business necessity, it still may be found to be in violation if an alternative policy or practice could serve the same purpose with less discriminatory effect. Finally, evidence of *discriminatory intent* is not necessary to establish that a lender's adoption or implementation of a policy or practice that has a disparate impact is in violation of the FH Act or ECOA.

These procedures do not call for examiners to plan examinations to identify or focus on potential disparate impact issues. The guidance in this Introduction is intended to help examiners recognize potential disparate impact situations if they happen to encounter them. Guidance in the Appendix tells them how to obtain relevant information regarding such situations and how to evaluate and follow up on it, as appropriate.

General Guidelines

These procedures are intended to be a basic and flexible framework to be used in the majority of fair lending examinations conducted by the FFIEC agencies. They are also intended to guide examiner judgment, not to supplant it. The procedures can be augmented by each agency, which can supply such additional procedures and details as are necessary to implement them effectively.

Although these procedures will apply to most examinations, each agency may continue to use for limited numbers of examinations the distinct approaches it has developed that are appropriate for select classes of institutions. Such approaches include, for example, the statistical modeling that some of the agencies use in selected examinations to assist in determining whether race or national origin was a factor in credit decisions.

For a number of aspects of lending -- for example, credit scoring and loan pricing -- the "state of the art" is more likely to be advanced if the agencies have some latitude to incorporate promising innovations. These interagency procedures provide for that.

Any references in these procedures to options, judgment, etc., of "examiners" means discretion within the limits provided by that examiner's agency. An examiner should use these procedures in conjunction with his or her own agency's priorities, examination philosophy, and detailed guidance for implementing these procedures. These procedures should not be interpreted as providing an examiner greater latitude than his or her own agency would. For example, if an agency's policy is to review compliance management systems even in small banks, an examiner for that agency must conduct such a review rather than interpret Part II of these interagency procedures as leaving the review to the examiner's option.

The procedures emphasize racial and national origin discrimination in residential transactions, but the key principles can be applied to other prohibited bases and to nonresidential transactions.

Finally, these procedures focus on analyzing lender compliance with the broad, nondiscriminatory requirements of the ECOA and the FH Act. They do not address such explicit or technical compliance provisions as the signature rules or adverse action notice requirements in sections 202.7 and 202.9, respectively, of Regulation B.

PART I - EXAMINATION SCOPE GUIDELINES

Background

The **scope** of an examination encompasses the loan product(s), market(s), decision center(s), time frame, and prohibited basis and control group(s) to be analyzed during the examination. These procedures refer to each potential combination of those elements as a "**Focal Point.**" Setting the scope of an examination involves, first, identifying all of the potential focal points that appear worthwhile to examine. Then, from among those, examiners select the focal point(s) that will form the scope of the examination, based on risk factors, priorities established in these procedures or by their respective agencies, the record from past examinations, and other relevant guidance. This phase includes obtaining an overview of an institution's compliance management system as it relates to fair lending.

Scoping may disclose the existence of circumstances -- such as the use of credit scoring or the amount of residential lending--which, under an agency's policy, call for the use of regression analysis or other statistical methods of identifying potential discrimination with respect to one or more loan products. Where that is the case, the agency's specialized procedures should be employed for such loan products rather than the procedures set forth below.

Setting the intensity of an examination means determining the breadth and depth of the analysis that will be conducted on the selected loan product(s). This process entails a more involved consideration of compliance management quality, particularly as it relates to selected products, to reach an informed decision regarding how large a sample of files to review in any transactional analyses performed and whether certain aspects of the credit process deserve heightened scrutiny.

Part I of these procedures provides guidance on establishing the scope of the examination. Part II (Compliance Management Review) provides guidance on determining the intensity of the examination. There is naturally some interdependence between these two phases. Ultimately the scope and intensity of the examination will determine the record of performance that serves as the foundation for agency conclusions about institutional compliance with fair lending obligations. The examiner should employ these procedures and the organization of these guidelines to arrive at a well-reasoned and practical conclusion about how to conduct a particular institution's examination of fair lending performance.

In cases where information already in the possession of an agency provides examiners with guidance on priorities and risks for planning an upcoming examination, such information may expedite the scoping process and make it unnecessary to carry out all of the steps below. For example, the report of the previous fair lending examination may have included recommendations for the focus of the next examination.

The scoping process can be performed either off-site, onsite, or both, depending on whatever is determined most feasible. In the interest of minimizing burdens on both the examination team and the lender, requests for information from the institution should be carefully thought out so as to include only the information that will clearly be useful in the examination process. Finally, any off-site information requests should be made sufficiently in advance of the on-site schedule to permit institutions adequate time to assemble necessary information and provide it to the examination team in a timely fashion. (See the **Appendix** on **"Potential Scoping Information"** for guidance on additional information that the examiner might wish to consider including in a request).

Examiners should focus the examination based on:

- An understanding of the credit operations of the institution
- The risk that discriminatory conduct may occur in each area of those operations
- The feasibility of developing a factually reliable record of an institution's performance and fair lending compliance in each area of those operations.

<u>1. Understanding Credit Operations</u>

Before evaluating the potential for discriminatory conduct, the examiner should review sufficient information about the institution and its market to understand the credit operations of the institution and the representation of prohibited basis group residents within the markets where the institution does business. The level of detail to be obtained at this stage should be sufficient to identify whether any of the risk factors in the Steps below are present. Relevant background information includes:

- The types and terms of credit products offered, differentiating among residential, consumer and other categories of credit
- The volume of, or growth in, lending for each of the credit products offered
- The demographics (i.e., race, national origin, etc.) of the credit markets in which the institution is doing business
- The institutions organization of its credit decision-making process, including identification of the delegation of separate lending authorities and the extent to which discretion in pricing or setting credit terms and conditions is delegated to various levels of managers, employees or independent brokers or dealers
- The types of relevant documentation/data that are available for various loan products and

what is the relative quantity, quality and accessibility of such information. I.e., for which loan product(s) will the information available be most likely to support a sound and reliable fair lending analysis

- The extent to which information requests can be readily organized and coordinated with other compliance examination components to reduce undue burden on the institution. (Do not request more information than the exam team can be expected to utilize during the anticipated course of the examination.)

In thinking about an institutions credit markets, the examiner should recognize that these markets may or may not coincide with an institutions CRA assessment area(s). Where appropriate, the examiner should review the demographics for a broader geographic area than the assessment area.

Where an institution has multiple underwriting or loan processing centers or subsidiaries, each with fully independent credit-granting authority, consider evaluating each center and/or subsidiary separately, provided a sufficient number of loans exist to support a meaningful analysis. In determining the scope of the examination for such institutions, examiners should consider whether:

- Subsidiaries should be examined. The agencies will hold a financial institution responsible for violations by its direct subsidiaries, but not typically for those by its affiliates (unless the affiliate has acted as the agent for the institution or the violation by the affiliate was known or should have been known to the institution before it became involved in the transaction or purchased the affiliate's loans). When seeking to determine an institution's relationship with affiliates that are not supervised financial institutions, limit the inquiry to what can be learned in the institution and do not contact the affiliate.

- The underwriting standards and procedures used in the entity being reviewed are used in related entities not scheduled for the planned examination. This will help examiners to recognize the potential scope of policy-based violations.

- The portfolio consists of applications from a purchased institution. If so, for scoping purposes, examiners should consider the applications as if they were made to the purchasing institution. (For comparison purposes, applications evaluated under the purchased institution's standards should not be compared to applications evaluated under the purchasing institution's standards.

- The portfolio includes purchased loans. If so, examiners should look for indications that the institution specified loans to purchase based on a prohibited factor or caused a prohibited factor to influence the origination process.

- A complete decision can be made at one of the several underwriting or loan processing centers, each with independent authority. In such a situation, it is best to conduct on-site a separate comparative analysis at each underwriting center. If covering multiple centers is not feasible during the planned examination, examiners should review one during the planned examination and others in later examinations.

- Decision-making responsibility for a single transaction may involve more than one underwriting center. For example, an institution may have authority to decline mortgage applicants, but only the mortgage company subsidiary may approve them. In such a situation, examiners should learn which standards are applied in each entity and the location of records needed for the planned comparisons.

- Any third parties, such as brokers or contractors, are involved in the credit decision and how responsibility is allocated among them and the institution. The institution's familiarity with third party actions may be important, for a bank may be in violation if it participates in transactions in which it knew or reasonably ought to have known other parties were discriminating.

If the institution is large and geographically diverse, examiners should select only as many markets or underwriting centers as can be reviewed readily in depth, rather than selecting proportionally to cover every market. As needed, examiners should narrow the focus to the MSA or underwriting center that is determined to present the highest discrimination risk. Examiners should use LAR data organized by underwriting center, if available. After calculating denial rates between the control group and minorities for the underwriting centers, examiners should select the centers with the highest disparities. If underwriting centers have fewer than five black, Hispanic, or Native American denials, examiners should not examine for racial discrimination. Instead, they should shift the focus to other loan products or prohibited bases.

2. Evaluating the Potential for Discriminatory Conduct

Step One: Develop an Overview

Based on his or her understanding of the credit operations and product offerings of an institution, an examiner should determine the nature and amount of information required for the scoping process and should obtain and organize that information. No single examination can reasonably be expected to evaluate compliance performance as to every prohibited basis, in every product, or in every underwriting center or subsidiary of an institution. In addition to information gained in the process of Understanding Credit Operations, above, the examiner should keep in mind the following factors when selecting products for the scoping review:

- Which products and prohibited bases were reviewed during the most recent prior examination(s) and, conversely, which products and prohibited bases have not recently been reviewed?
- Which prohibited basis groups make up a significant portion of the institution's market for the different credit products offered?

Based on consideration of the foregoing factors, the examiner should request information for all residential and other loan products considered appropriate for scoping in the current examination cycle. In addition, wherever feasible, examiners should conduct preliminary interviews with the lender's key underwriting personnel. Using the accumulated information, the examiner should evaluate the following, as applicable:

- Underwriting guidelines, policies, and standards
- Descriptions of credit scoring systems, including a list of factors scored, cutoff scores, extent of validation, and any guidance for handling overrides and exceptions. (Refer to **Part A** of the **Credit Scoring Analysis** section of the **Appendix** for guidance)
- Applicable pricing policies and guidance for exercising discretion over loan terms and conditions
- The institution's corporate relationships with any finance companies, subprime mortgage or consumer lending entities, or similar institutions
- Loan application forms
- HMDA/LAR or loan registers and lists of declined applications
- Description(s) of databases maintained for loan product(s) to be reviewed, especially any record of exceptions to underwriting guidelines
- Copies of any consumer complaints alleging discrimination and loan files related thereto
- Descriptions of any compensation system that is based on loan production or pricing
- Compliance program materials (particularly fair lending policies), training manuals, organization charts, as well as record keeping and any monitoring protocols
- Copies of any available marketing materials or descriptions of current or previous marketing plans or programs.

Step Two: Identify Compliance Program Discrimination Risk Factors

Review information from agency examination work papers, institutional records and any available discussions with management representatives in sufficient detail to understand the organization, staffing, training, recordkeeping, auditing and policies of the institutions fair lending compliance systems. Review these systems and note the following risk factors:

C1. Overall institution compliance record is weak.

C2. Prohibited basis monitoring information is incomplete.

C3. Data and/or record-keeping problems compromised reliability of previous examination reviews.

C4. Fair lending problems were previously found in one or more bank products.

C5. The size, scope, and quality of the compliance management program, including senior management's involvement, is materially inferior to programs customarily found in institutions of similar size, market demographics and credit complexity.

C6. The institution has not updated compliance guidance to reflect changes in law or in agency policy.

Consider these risk factors and their impact on particular lending products and practices as you conduct the product specific risk review during the scoping steps that follow. Where this review identifies fair lending compliance system deficiencies, give them appropriate consideration as part of the Compliance Management Review in Part II of these procedures.

Step Three: Review Residential Loan Products

Although home mortgages may not be the ultimate subject of every fair lending examination, this product line must at least be considered in the course of scoping every institution that is engaged in the residential lending market.

Divide home mortgage loans into the following groupings: home purchase, home improvements, and refinancings. Subdivide those three groups further if an institution does a significant number of any of the following types or forms of residential lending, and consider them separately:

- Government-insured loans
- Mobile home or factory housing loans
- Wholesale, indirect and brokered loans
- Portfolio lending (including portfolios of Fannie Mae/Freddie Mac rejections)

In addition, determine whether the lender offers any conventional affordable housing loan programs and whether their terms and conditions make them incompatible with regular conventional loans for comparative purposes. If so, consider them separately.

If previous examinations have demonstrated the following, then an examiner may limit the focus of the current examination to alternative underwriting or processing centers or to other residential products that have received less scrutiny in the past:

- A strong fair lending compliance program
- No record of discriminatory transactions at particular decision centers or in particular residential products
- No indication of a significant change in personnel, operations or underwriting standards at those centers or in those residential products
- No unresolved fair lending complaints, administrative proceedings, litigation or similar factors.

Step Four: Identify Residential Lending Discrimination Risk Factors

- Review the lending policies, marketing plans, underwriting, appraisal and pricing guidelines, broker/agent agreements and loan application forms for each residential loan product that represents an appreciable volume of, or displays noticeable growth in, the institution's residential lending.

- Review also any available data regarding the geographic distribution of the institution's loan originations with respect to the race and national origin percentages of the census tracts within its assessment area or, if different, its residential loan product lending area(s).
- Conduct interviews of loan officers and other employees or agents in the residential lending process concerning adherence to and understanding of the above policies and guidelines as well as any relevant operating practices.
- In the course of conducting the foregoing inquiries, look for the following risk factors (factors are numbered alphanumerically to coincide with the type of factor, e.g., "O" for "overt"; "P" for "pricing", etc.):

***Overt** indicators of discrimination such as:*

O1. Including explicit prohibited basis identifiers in underwriting criteria or pricing standards

O2. Collecting information, conducting inquiries or imposing conditions contrary to express requirements of Regulation B

O3. Including variables in a credit scoring system that constitute a basis or factor prohibited by Regulation B or, for residential loan scoring systems, the FH Act. (If a credit scoring system scores age, refer to **Part E** of the **Credit Scoring Analysis** section of the **Appendix**.)

O4. Statements made by the institution's officers, employees or agents which constitute an express or implicit indication that one or more such persons have engaged or do engage in discrimination on a prohibited basis in any aspect of a credit transaction

O5. Employee or institutional statements that evidence attitudes based on prohibited basis prejudices or stereotypes.

NOTE: For risk factors below that are marked with an asterisk, examiners need not attempt to calculate the indicated ratios for racial or national origin characteristics when the institution in not a HMDA reporter. However, consideration should be given in such cases to whether or not such calculations should be made based on gender or racial-ethnic surrogates.

Indicators of potential disparate treatment in Underwriting such as:

U1. *****Substantial disparities among the approval/denial rates for applicants by monitored prohibited basis characteristic (especially within income categories)

U2. *****Substantial disparities among the application processing times for applicants by monitored prohibited basis characteristic (especially within denial reason groups)

U3. *****Substantially higher proportion of withdrawn/incomplete applications from prohibited basis group applicants than from other applicants

U4. Vague or unduly subjective underwriting criteria

U5. Lack of clear guidance on making exceptions to underwriting criteria, including credit scoring overrides

U6. Lack of clear loan file documentation regarding reasons for any exceptions to normal underwriting standards, including credit scoring overrides

U7. Relatively high percentages of either exceptions to underwriting criteria or overrides of credit score cutoffs

U8. Loan officer or broker compensation based on loan volume (especially loans approved per period of time)

U9. Consumer complaints alleging discrimination in loan processing or in approving/denying residential loans.

Indicators of potential ***disparate treatment in Pricing*** *(interest rates, fees, or points) such as:*

P1. Relationship between loan pricing and compensation of loan officers or brokers

P2. Presence of broad discretion in pricing or other transaction costs

P3. Use of a system of risk-based pricing that is not empirically based and statistically sound

P4. *****Substantial disparities among prices being quoted or charged to applicants who differ as to their monitored prohibited basis characteristics

P5. Consumer complaints alleging discrimination in residential loan pricing.

Indicators of potential ***disparate treatment by Steering*** *such as:*

S1. For an institution that has one or more subprime mortgage subsidiaries or affiliates, any significant differences, by loan product, in the percentage of prohibited basis applicants of the institution compared with the percentage of prohibited basis applicants of the subsidiary(ies) or affiliate(s)

S2. Lack of clear, objective standards for (i) referring applicants to subsidiaries or affiliates, (ii) classifying applicants as “prime” or “subprime” borrowers, or (iii) deciding what kinds of alternative loan products should be offered or recommended to applicants

S3. For an institution that makes both conventional and FHA mortgages, any significant differences in the percentages of prohibited basis group applicants in each of these two loan products, particularly with respect to loan amounts of $100,000 or more

S4. For an institution that makes both prime and sub-prime loans for the same purpose, any significant differences in percentages of prohibited basis group borrowers in each of the alternative loan product categories

S5. Consumer complaints alleging discrimination in residential loan pricing

S6. A lender with a sub-prime mortgage company subsidiary or affiliate integrates loan application processing for both entities, such that steering between the prime and sub-prime products can occur almost seamlessly; *i.e.*, a single loan processor could simultaneously attempt to qualify any applicant, whether to the bank or the mortgage company, under either the bank’s prime criteria or the mortgage company’s sub-prime criteria

S7. Loan officers have broad discretion regarding whether to promote conventional or FHA loans, or both, to applicants and the lender has not issued guidelines regarding the exercise of this discretion

S8. A lender has most of its branches in predominantly white neighborhoods. The lender's subprime mortgage subsidiary has branches which are located primarily in predominantly minority neighborhoods.

Indicators of potential ***discriminatory Redlining*** *such as:*

R1. *****Significant differences, as revealed in HMDA data, in the number of loans originated in those areas in the lender's market that have relatively high concentrations of minority group residents compared with areas with relatively low concentrations of minority residents.

R2. *****Significant differences between approval/denial rates for *all* applicants (minority and nonminority) in areas with relatively high concentrations of minority group residents compared with areas with relatively low concentrations of minority residents.

R3. *****Significant differences between denial rates based on insufficient collateral for applicants from areas with relatively high concentrations of minority residents and those areas with relatively low concentrations of minority residents.

R4. Other patterns of lending identified during the most recent CRA examination that differ by the concentration of minority residents.

R5. Explicit demarcation of credit product markets that excludes MSAs, political subdivisions, census tracts, or other geographic areas within the institution's lending market and having relatively high concentrations of minority residents.

R6. Policies on receipt and processing of applications, pricing, conditions, or appraisals and valuation, or on any other aspect of providing residential credit that vary between areas with relatively high concentrations of minority residents and those areas with relatively low concentrations of minority residents.

R7. Employee statements that reflect an aversion to doing business in areas with relatively high concentrations of minority residents.

R8. Complaints or other allegations by consumers or community representatives that the lender excludes or restricts access to credit for areas with relatively high concentrations of minority residents. Examiners should review complaints against the lender filed with their agency; the CRA public comment file; community contact forms; and the responses to questions about redlining, discrimination, and discouragement of applications, and about meeting the needs of racial or national origin minorities, asked as part of "obtaining local perspectives on the performance of financial lenders" during prior CRA examinations.

NOTE: Broad allegations or complaints are not, by themselves, sufficient justification to shift the focus of an examination from routine comparative review of applications to redlining analysis. Such a shift should be based on complaints or allegations of specific practices or incidents that are consistent with redlining, along with the existence of other risk factors.

R9. A lender that has most of its branches in predominantly white neighborhoods at the same time that the lender's subprime mortgage subsidiary has branches which are located primarily in predominantly minority neighborhoods.

Indicators of potential ***disparate treatment in Marketing*** *of residential products, such as:*

M1. Advertising patterns or practices that a reasonable person would believe indicate prohibited basis customers are less desirable.

M2. Advertising only in media serving nonminority areas of the market.

M3. Marketing through brokers or other agents that the lender knows (or has reason to know) would serve only one racial or ethnic group in the market.

M4. Use of marketing programs or procedures for residential loan products that exclude one or more regions or geographies within the lenders assessment or marketing area that have significantly higher percentages of minority group residents than does the remainder of the assessment or marketing area.

M5. Using mailing or other distribution lists or other marketing techniques for pre-screened or other offerings of residential loan products** that:

- Explicitly exclude groups of prospective borrowers on a prohibited basis; or
- Exclude geographies (e.g., census tracts, ZIP codes, etc.) within the institution's marketing area that have significantly higher percentages of minority group residents than does the remainder of the marketing area.

**** NOTE:** Pre-screened solicitation of potential applicants on a prohibited basis does not violate ECOA. Such solicitations are, however, covered by the FH Act. Consequently, analyses of this form of potential marketing discrimination should be limited to residential loan products subject to coverage under the FH Act.

M6. ***Proportion of monitored prohibited basis applicants is significantly lower than that group's representation in the total population of the market area.

M7. Consumer complaints alleging discrimination in advertising or marketing loans.

Step Five: Organize and Focus Residential Risk Analysis

Review the risk factors identified in Step 4 and, for each loan product that displays risk factors, articulate the possible discriminatory effects encountered and organize the examination of those loan products in accordance with the following guidance:

- Where **overt** evidence of discrimination, as described in factors O1-O5, has been found in connection with a product, document those findings as described in Part III, A, besides completing the remainder of the planned examination analysis.
- Where any of the risk factors U1-U9 are present, consider conducting an **underwriting comparative file analysis** as described in Part III, B.
- Where any of the risk factors P1-P5 are present, consider conducting a **pricing comparative file analysis** as described in Part III, C.
- Where any of the risk factors S1-S8 are present, consider conducting a **steering analysis** as described in Part III, D.
- Where any of the risk factors R1-R9 are present, consult agency managers about conducting an analysis for **redlining** as described in Part III, F.
- Where any of the risk factors M1-M7 are present, consult agency managers about conducting a **marketing analysis** as described in Part III, G.
- Where an institution uses age in any credit scoring system, consider conducting an examination analysis of that credit scoring system's compliance with the requirements of Regulation B as described in Part III, H.

Step Six: Identify Consumer Lending Discrimination Risk Factors

For credit card, motor vehicle, home equity and other consumer loan products selected in Step One for risk analysis in the current examination cycle, conduct a risk factor review similar to that conducted for residential lending products in Steps Three through Five, above. Consult with agency managers regarding the potential use of surrogates to identify possible prohibited basis group individuals.

NOTE: The term **surrogate** in this context refers to any factor related to a loan applicant that potentially identifies that applicant's race, color or other prohibited basis characteristic in instances where no direct evidence of that characteristic is available. Thus, in consumer lending, where monitoring data is generally unavailable, an outwardly Hispanic or Asian surname could constitute a surrogate for an applicant's race or national origin because then examiner can assume that the lender (who can rebut the presumption) perceived the person to be Hispanic. Similarly, an applicant's given name could serve as a surrogate for his or her gender. A surrogate for a prohibited basis characteristic may be used as to set up a comparative analysis with nonminority applicants or borrowers.

Using decision rules in Steps 3 - 5, above, for residential lending products, articulate the possible discriminatory patterns encountered and consider examining those products determined to have sufficient risk of discriminatory conduct.

Step Seven: Analyze Commercial Lending Discrimination Risk

Where an institution does a substantial amount of lending in the commercial lending market, most notably small business loans (and the product has not recently been examined or the underwriting standards have changed since the last examination of the product), the examiner should consider conducting a risk factor review similar to that performed for residential lending products, as feasible, given the limited information available. Such an analysis should generally be limited to determining risk potential based on risk factors U4-U8; P1-P3; R4-R7; and M1-M3.

If the institution makes commercial loans insured by the Small Business Administration (SBA), determine from agency supervisory staff whether SBA loan data (which codes race and other factors) are available for the institution and evaluate those data pursuant to instructions accompanying them.

For large institutions reporting small business loans for CRA purposes and where the institution also voluntarily geocodes loan denials, look for material discrepancies in ratios of approval-to-denial rates for applications in areas with relatively high concentrations of minority residents compared with areas with relatively low concentrations.

Articulate the possible discriminatory patterns identified and consider further examining those products determined to have sufficient risk of discriminatory conduct in accordance with the procedures for commercial lending described in Part III, F.

Step 8: Complete the Scoping Process

To complete the scoping process, the examiner should review the results of the preceding steps and select those focal points that warrant examination, based on the relative risk levels identified above. In order to remain within the agency's resource allowances, the examiner may need to choose a smaller number of Focal Points from among all those selected on the basis of risk. In such instances, set the scope by first, prioritizing focal points on the basis of (i) high number and/or relative severity of risk factors; (ii) high data quality and other factors affecting the likelihood of obtaining reliable examination results; (iii) high loan volume and the likelihood of widespread risk to applicants and borrowers; and (iv) low quality of any compliance program and, second, selecting for examination review as many focal points as resources permit.

Where the judgment process among competing Focal Points is a close call, information learned in the phase of conducting the compliance management review can be used to further refine the examiner's choices.

PART II - COMPLIANCE MANAGEMENT REVIEW

The Compliance Management Review enables the examination team to determine:

- The intensity of the current examination based on an evaluation of the compliance management measures employed by an institution
- The reliability of the institution's practices and procedures for ensuring continued fair lending compliance.

For regulators whose policy is that examinations of certain types of institutions should focus on factors or conditions other than the quality of an institution's compliance programs (such as performance in transactions), examiners should follow that policy.

Generally, the review should focus on

- Determining whether the policies and procedures of the institution enable management to prevent, or to identify and self-correct, illegal disparate treatment in the transactions that relate to the products and issues identified for further analysis under Part I of these procedures
- Obtaining a thorough understanding of the manner by which management addresses its fair lending responsibilities with respect to (a) the institution's lending practices and standards, (b) training and other application-processing aids, (c) guidance to employees or agents in dealing with customers, and (d) its marketing or other promotion of products and services.

To conduct this review, examiners should consider institutional records and interviews with appropriate management personnel in the lending, compliance, audit, and legal functions. The examiner should also refer to the Compliance Management Analysis Checklist contained in the Appendix to evaluate the strength of the compliance programs in terms of their capacity to prevent, or to identify and self-correct, fair lending violations in connection with the products or issues selected for analysis. Based on this evaluation

- Set the intensity of the transaction analysis by minimizing sample sizes within the guidelines established in Part III and the **Sample Size Table** in the **Appendix**, to the extent warranted by the strength and thoroughness of the compliance programs applicable to those Focal Points selected for examination

- Identify any compliance program or system deficiencies that merit correction or improvement and present these to management in accordance with Part IV of these procedures.

Where an institution performs a self-evaluation of any product or issue that is within the scope of the examination and has been selected for analysis pursuant to Part I of these procedures, examiners may streamline the examination, consistent with agency instructions, provided the self-evaluation meets the requirements set forth in **Streamlining the Examination** located in the **Appendix**.

PART III - EXAMINATION PROCEDURES

Once the scope and intensity of the examination have been determined, assess the institution's fair lending performance by applying the appropriate procedures that follow to each of the examination Focal Points already selected.

A. Documenting Overt Evidence of Disparate Treatment

Where the scoping process or any other source identifies overt evidence of disparate treatment, the examiner should assess the nature of the policy or statement and the extent of its impact on affected applicants by conducting the following analysis

Step 1. Where the indicator(s) of overt discrimination are found in or based on a written policy (for example, a credit scorecard) or communication, determine and document:

a. The precise language of the apparently discriminatory policy or communication and the nature of the fair lending concerns that it raises

b. The lender's stated purpose in adopting the policy or communication and the identity of the person on whose authority it was issued or adopted

c. How and when the policy or communication was put into effect

d. How widely the policy or communication was applied

e. Whether and to what extent applicants were adversely affected by the policy or communication.

Step 2. Where any indicator of overt discrimination was an oral statement or unwritten practice, determine and document

a. The precise nature of both the statement or practice and of the fair lending concerns that they raise

b. The identity of the persons making the statement or applying the practice and their descriptions of the reasons for it and the persons authorizing or directing the use of the statement or practice

c. How and when the statement or practice was disseminated or put into effect

d. How widely the statement or practice was disseminated or applied

e. Whether and to what extent applicants were adversely affected by the statement or practice.

Assemble findings and supporting documentation for presentation to management in connection with Part IV of these procedures.

B. Transactional Underwriting Analysis - Residential and Consumer Loans.

Step 1: Set Sample Size

a. For each Focal Point selected for this analysis, two samples will be utilized: (i) prohibited basis group denials and (ii) control group approvals, both identified either directly from monitoring information in the case of residential loan applications or through the use of application data or surrogates in the case of consumer applications.

b. Refer to the **Fair Lending Sample Size Table A** in the **Appendix** and determine the size of the initial sample for each Focal Point, based on the number of prohibited basis group denials and the number of control group approvals by the lender during the twelve month (or calendar year) period of lending activity preceding the examination. In the event that the number of denials and/or approvals acted on during the preceding 12 month period substantially exceeds the maximum sample size shown in Table A, reduce the time period from which that sample is selected to a shorter period. (In doing so, make every effort to select a period in which the lender's underwriting standards are most representative of those in effect during the full 12 month period preceding the examination.)

c. If the number of prohibited basis group denials or control group approvals for a given Focal Point that were acted upon during the 12 month period referenced in 1.b., above, do not meet the minimum standards set forth in the Sample Size Table, examiners need not attempt a transactional analysis for that Focal Point. Where other risk factors favor analyzing such a Focal Point, consult with agency managers on possible alternative methods of judgmental comparative analysis.

d. If agency policy calls for a different approach to sampling (e.g., a form of statistical analysis or a mathematical formula) for a limited class of institutions, examiners should follow that approach.

Step 2: Determine Sample Composition.

a. To the extent the institution maintains records of loan outcomes resulting from exceptions to its credit underwriting standards or other policies (e.g., overrides to credit score cutoffs), request such records for both approvals and denials, sorted by loan product and branch or decision center, if the lender can do so. Include in the initial sample for each Focal Point all exceptions or overrides applicable to that Focal Point.

b. Using HMDA/LAR data or, for consumer loans, comparable loan register data to the extent available, choose approved and denied applications based on selection criteria that will maximize the likelihood of finding marginal approved and denied applicants, as discussed below.

c. To the extent that the above factors are inapplicable or other selection criteria are unavailable or do not facilitate selection of the entire sample size of files, complete the initial sample selection by making random file selections from the appropriate sample categories in the Sample Size Table.

Step 3: Compare Approved and Denied Applications

__**Overview**__: Although a creditor's written policies and procedures may appear to be nondiscriminatory, lending personnel may interpret or apply policies in a discriminatory manner. In order to detect any disparate treatment among applicants, the examiner should first eliminate all but "**marginal transactions**" (see 3.b. below) from each selected Focal Point sample. Then, a detailed profile of each marginal applicant's qualifications, the level of assistance received during the application process, the reasons for denial, the loan terms, and other information should be recorded on an Applicant Profile Spreadsheet. Once profiled, the examiner can compare the target and control groups for evidence that similarly qualified applicants have been treated differently as to either the institution's credit decision or the quality of assistance provided.

a. <u>Create Applicant Profile Spreadsheet</u>

Based upon the lender's written and/or articulated credit standards and loan policies, identify categories of data that should be recorded for each applicant and provide a field for each of these categories on a worksheet or computerized spreadsheet. Certain data (income, loan amount, debt, etc.) should always be included in the spreadsheet, while the other data selected will be tailored for each loan product and lender based on applicable underwriting criteria and such issues as branch location and underwriter. Where credit bureau scores and/or application scores are an element of the lender’s underwriting criteria (or where such information is regularly recorded in loan files, whether expressly used or not), include a data field for this information in the spread sheet.

In order to facilitate comparisons of the quality of assistance provided to target and control group applicants, respectively, every work sheet should provide a “comments” block appropriately labeled as the site for recording observations from the file or interviews regarding how an applicant was, or was not, assisted in overcoming credit deficiencies or otherwise qualifying for approval. (See **Workpaper Appendix** for sample spreadsheets.)

b. <u>Complete Applicant Profiles</u>

From the application files sample for each Focal Point, complete applicant profiles for selected denied and approved applications as follows:

- A principal goal is to identify cases where similarly qualified prohibited basis and control group applicants had different credit outcomes, because the agencies have found that discrimination, including differences in granting assistance during the approval process, is more likely to occur with respect to applicants who are *not* either clearly qualified or unqualified, i.e., “**marginal”** applicants. The examiner-in-charge should, during the following steps, **judgmentally select** from the initial sample only those denied and approved applications which constitute **marginal transactions.** (See **Appendix** on **Marginal Transactions** for guidance)
- If few marginal control group applicants are identified from the **initial sample**, review additional files of approved control group applicants. This will either increase the number of marginal approvals or confirm that marginal approvals are so infrequent that the marginal denials are unlikely to involve disparate treatment.
- The judgmental selection of both **marginal-denied** and **marginal-approved** applicant loan files should be done together, in a back and forth manner, to facilitate close matches and a more consistent definition of marginal between these two types of loan files.
- Once the marginal files have been identified, the data elements called for on the profile spreadsheet are extracted or noted and entered.
- While conducting the preceding step, the examiner should simultaneously look for and document on the spreadsheet any evidence found in marginal files regarding the following:
  - the **extent of any assistance**, including both **affirmative aid** and **waivers or partial waivers** of credit policy provisions or requirements, that appears to have been provided to **marginal-approved** control group applicants which enabled them to overcome one or more credit deficiencies, such as excessive debt-to-income ratios
  - the extent to which **marginal-denied** target group applicants with similar deficiencies were, or were not, provided similar affirmative aid, waivers or other forms of assistance.

c. <u>Review and Compare Profiles</u>

- For each Focal Point, review all **marginal profiles** to determine if the underwriter followed institution lending policies in denying applications and whether the reason(s) for denial were supported by facts documented in the loan file and properly disclosed to the applicant pursuant to Regulation B. If any (a) unexplained deviations from credit standards, (b) inaccurate reasons for denial or (c) incorrect disclosures are noted, (whether in a judgmental underwriting system, a scored system or a mixed system) the examiner should obtain an explanation from the underwriter and document the response on an appropriate workpaper.

NOTE: In constructing the applicant profiles to be compared, examiners must adjust the facts compared so that assistance, waivers, or acts of discretion are treated consistently between applicants. For example, if a control group applicant's DTI ratio was lowered to 42% because the lender decided to include short-term overtime income, and a prohibited basis group applicant who was denied due to "insufficient income" would have had his ratio drop from 46% to 41% if his short-term overtime income had been considered, then the examiners should consider 41%, not 46%, in determining the benchmark.

- For each **reason for denial** identified within the target group, rank the denied prohibited basis applicants, beginning with the applicant whose qualification(s) related to that reason for denial were **least deficient**. (The top-ranked denied applicant in each such ranking will be referred to below as the **"benchmark"** applicant.)
- Compare each marginal control group approval to the **benchmark** applicant in each reason-for-denial ranking developed in step (b), above. If there are no approvals who are equally or less qualified, then there are no instances of disparate treatment for the lender to account for. For all such approvals that appear no better qualified than the denied benchmark applicant
    - identify the approved loan on the worksheet or spreadsheet as an **"overlap approval"**, and
    - compare that overlap approval with other marginal prohibited basis denials in the ranking to determine whether additional overlaps exist. If so, identify all overlapping approvals and denials as above.
- Where the Focal Point involves use of a credit scoring system, the analysis for disparate treatment is similar to the procedures set forth in (c) above, and should focus primarily on overrides of the scoring system itself. For guidance on this type of analysis, refer to **Part C** of the **Credit Scoring** section of the **Appendix**.

Step 4. If there is some evidence of violations in the underwriting process but not enough to clearly establish the existence of a pattern or practice, the examiner should expand the sample as necessary to determine whether a pattern or practice does or does not exist.

Step 5. Discuss all findings resulting from the above comparisons with bank management and document both the findings and all conversations on an appropriate worksheet.

C. Analyzing Potential Disparities in Terms and Conditions.

Step 1: Set Sample Size

For each Focal Point selected for this analysis, two samples will be utilized: (i) prohibited basis group approvals and (ii) control group approvals, both identified either directly from monitoring information in the case of residential loan applications or through the use of application data or surrogates in the case of consumer or commercial applications. Refer to the **Fair Lending Sample Size Table B** in the **Appendix** and determine the size of the initial sample for each Focal Point, based on the number of prohibited basis group approvals and the number of control group approvals received by the lender during the 12 months preceding the examination and the outcome of the compliance management system analysis conducted in Part II.

Step 2: Determine Sample Composition

NOTE: Sample composition for a comparison of price and other terms and conditions will initially focus on controlling for two nondiscriminatory variables that can have a significant impact on loan terms: whether the loan was sold and the loan closing date. Other variables, such as household income and loan amount, will be accounted for on a case-by-case basis during the file comparison process.

a. Disposition of Loan

Determine whether approved loans from which the sample is to be drawn have been consistently sold to the secondary market or held in portfolio. If both, determine the proportion for each category and use that proportion in selecting loans from each category for the sample. If the number of loans in either the sold or portfolio categories is too small to complete the minimum proportional sample size for that category, ignore loans in that category and complete the sample using loans solely from the larger category.

b. Period of Review

Sort loans selected in (1) , above, by **date of loan closing** and match batches of prohibited basis and control group loans that closed either on the same date or within a **range of dates** during which the lender's pricing policies were the same. If dates of loan closing are not consistently available, consider substituting the application date for the closing date.

Step 3: Create Applicant Profile Spreadsheet

Identify data that should be recorded for each loan to allow for a valid comparison regarding terms and conditions and place these onto a spreadsheet. Certain data must always be included in the spreadsheet, while the other data selected will be tailored for each loan product and lender based on loan terms offered and such issues as branch location and underwriter.

Step 4: Review Terms and Conditions; Compare with Applicant Outcomes

a. Determine which loan terms and conditions (rates, points, fees, maturity variations, LTVs, collateral requirements, etc.) are left, in whole or in part, to the discretion of loan officers or underwriters. For each such term or condition, identify (a) any **approved prohibited basis group applicants** in the sample who appear to have been treated unfavorably with respect to that term or condition and (b) any **approved control group applicants** who appear to have been treated favorably with respect to that term or condition. The examiner's analysis should be thoroughly documented in the workpapers.

b. Identify from the sample any **approved control group applicant(s)** who appear to have been treated more favorably than one or more of the above-identified prohibited basis group applicants and who have negative creditworthiness factors (under the lender's standards) that are equal to or worse than the prohibited basis group applicant(s).

c. Obtain explanations from the appropriate loan officer or other employee for any differences that exist and reanalyze the sample for evidence of discrimination.

d. If there is some evidence of violations in the imposition of terms and conditions but not enough to clearly establish the existence of a pattern or practice, the examiner should expand the sample as necessary to determine whether a pattern or practice does or does not exist.

e. Discuss differences in comparable loans with the institution's management and document all conversations on an appropriate worksheet. For additional guidance on evaluating management's responses, refer to **Part A, 1 - 6, Evaluating Responses to Evidence of Disparate Treatment** in the **Appendix**.

D. Steering Analysis

Institutions that make FHA as well as conventional loans and those that lend in both prime or "A" markets and in sub-prime markets (either directly or through subsidiaries or affiliates), present opportunities for loan officers to refer or "steer" applicants from one product or market to another. Steering is not unlawful *per se* and, in many instances, the availability of a more expensive form of credit may enable an applicant with credit problems to obtain a loan that might otherwise be unavailable. Steering can, however, raise fair lending issues if it occurs differently and less advantageously for prohibited basis group applicants than for similarly-situated non-minority applicants. If the scoping analysis reveals the presence of one or more risk factors S1 through S8 for any selected Focal Point, consult with managers about conducting a steering analysis as described below.

From the perspective of fair lending analysis, all steering scenarios involve a **decision** by the lender's personnel to guide an applicant's choice between a **more favorable** loan and one or more **less favorable** alternatives (e.g., referral to a more expensive subprime mortgage subsidiary). As such, a steering analysis should be focused on answering the following questions:

Step 1: Clarify which of the options available to customers are the more favorable and less favorable.

Through interviews with appropriate personnel of the institution and review of policy manuals, procedure guidelines and other directives, obtain and verify the following information for each product-alternative product pairing or grouping identified above:

a. All underwriting criteria for the product and for the alternative product(s) that are offered by the institution or by a subsidiary or affiliate.

b. Pricing or other costs applicable to the product and the alternative product(s), including interest rates, points, and all fees.

Step 2: Document the policies, conditions or criteria that have been adopted by the lender for determining how referrals are to be made and choices presented to customers.

a. Obtain not only information regarding the product offered by the lender and alternative products offered by subsidiaries/affiliates, but also information on products and alternatives offered solely by the lender itself-, e.g., conventional and FHA, secured and unsecured home improvement loans, prime and subprime mortgages.

b. Obtain any information regarding a subsidiary of the lender directly from that entity, but seek information regarding an affiliate or holding company subsidiary only from the lender itself.

c. Obtain all appropriate documentation and document all discussions with loan personnel and managers.

d. Obtain documentation and/or employee estimates as to the volume of referrals made from or to the institution, for each product, during a relevant time period.

e. Resolve to the extent possible any discrepancies between information found in the lender's documents and information obtained in interviews by conducting appropriate follow-up interviews.

f. Identify any policies and procedures established by the institution and/or the subsidiary or affiliate for (i) referring a person who applies to the institution, but does not meet its criteria, to a subsidiary or affiliate; (ii) offering to a person who applies to the institution for *a specific product*, but does not meet its criteria, one or more alternative loan products; or (iii) referring a person who applies to a subsidiary or affiliate for its product, but who appears be qualified for a loan from the institution, to the institution.

g. Determine whether loan personnel are encouraged, through monetary incentives or otherwise, to make referrals, either from the institution to a subsidiary/affiliate or vice versa.

Step 3: Determine how both the decisions and the lender's policies. conditions or criteria are supposed to be documented in loan files, policy manuals. directives. etc..

Determine how, if at all, a referral from the institution to a subsidiary/affiliate, or vice versa, *and the reason for it,* would be documented in the loan files or in any other records of either the referring or receiving entity.

Step 4: Determine to what extent individual loan personnel are able to exercise personal discretion in deciding what loan products or other credit alternatives will be made available to a given applicant.

Step 5: Determine whether the lender's stated policies. conditions or criteria in fact are adhered to by individual decision makers. In the alternative. does it appear that different policies or practices are actually in effect?

Enter data from the prohibited basis group sample on the spread sheets and determine whether the lender is, in fact, applying its criteria as stated. For example, if one announced criterion for receiving a "more favorable" prime mortgage loan was a back end debt ratio of no more than 38%, review the spread sheets to determine whether that criteria was adhered to. If the lender's actual treatment of prohibited basis group applicants appears to differ from its stated criteria, document such differences for subsequent discussion with management.

Step 6: To the extent that individual loan personnel have any discretion in deciding what credit alternatives (e.g., conventional vs. FHA/VA) to offer applicants, conduct a comparative analysis to determine whether that discretion has been exercised in a nondiscriminatory manner.

Compare the lender's or subsidiary/affiliate's treatment of control group and prohibited basis group applicants by adapting the "benchmark" and "overlap" technique discussed in Part III, B. of these procedures. For purposes of this Steering Analysis, that technique should be conducted as follows:

a. For each Focal Point to be analyzed, select a sample of prohibited basis group applicants who received "less favorable" treatment (e.g., referral to a finance company or a subprime mortgage subsidiary or counteroffers of less favorable product alternatives).

   NOTE: In selecting the sample, follow the guidance of **Sample Size Table B** in the **Appendix** and select "marginal applicants" as instructed in Part III, Section B, above.

b. Prepare a spread sheet for the sample which contains data entry categories for those underwriting and/or referral criteria that the lender identified in Step 1. b as used in reaching underwriting and referral decisions between the pairs of products.

c. Review the "less favorably" treated prohibited basis group sample and rank this sample from least qualified to most qualified.

d. From the sample, identify the **best qualified** prohibited basis group applicant, based on the criteria identified for the control group, above. This applicant will be the **"benchmark"** applicant. Rank order the remaining applicants from best to least qualified.

e. Select a sample of *control group applicants*. Identify those who were treated "*more* favorably" with respect to the same product-alternative product pair as the *prohibited basis* group. (Again refer to the Sample Size Table B and marginal applicant processes noted above in selecting the sample.)

f. Compare the qualifications of the benchmark applicant with those of the control group applicants, beginning with the least qualified member of that sample. Any control group applicant who appears less qualified than the benchmark applicant should be identified on the spreadsheet as a **"control group overlap".**

g. Compare all control group overlaps with other, less qualified prohibited basis group applicants to determine whether additional overlaps exist

h. Document all overlaps as possible disparities in treatment. Discuss all overlaps and related findings (e.g., any differences between stated and actual underwriting criteria) with management, documenting all such conversations.

E. Transactional Underwriting Analysis - Commercial Loans.

Overview Unlike consumer credit, where loan products and prices are generally homogenous and underwriting involves the evaluation of a limited number of credit variables, commercial loans are generally unique and underwriting methods and loan pricing may vary depending on a large number of credit variables. The additional credit analysis that is involved in underwriting commercial credit products will entail additional complexity in the sampling and discrimination analysis process. Although ECOA prohibits discrimination as to all commercial credit activities of a covered institution, the agencies recognize that small businesses (sole proprietorships, partnerships, and small, closely-held corporations), including those operated by prohibited basis group members, may have less experience in borrowing. Therefore, in implementing these procedures, examinations should generally be focused on small business credit (commercial applicants that had gross revenues of $1,000,000 or less in the preceding fiscal year), absent some evidence that a focus on other commercial products would be more appropriate.

Step 1: Understand Commercial Loan Policies

For the commercial product line selected for analysis, the examiner should first review credit policy guidelines and interview appropriate commercial loan managers and officers to obtain written and articulated standards used by the lender in evaluating commercial loan applications.

Step 2: Conduct Initial Sampling

a. Select all (up to a maximum of ten) denied applications that were acted on during the three month period prior to the examination. To the extent feasible, include denied applications from businesses that are (i) located in minority and/or integrated geographies or (ii) appear to be owned by women or minority group members, based on the names of the principals shown on applications or related documents. (In the case of banks that do a significant volume of commercial lending, consider reviewing more than ten applications.)

b. For each of the **denied commercial applications** selected, record specific information from loan files and through interviews with the appropriate loan officer(s), about the principal owners, the purpose of the loan, and the specific, pertinent financial information about the commercial enterprise (including type of business - retail, manufacturing, service, etc.), that was used by the lender to evaluate the credit request on Small Business Loan Profile Spreadsheet. (See **Workpaper Appendix**) In addition, inquire with the loan officer as to the gender and race, if known, of the principals of the business.

c. Select ten approved loans that appear to be similar with regard to business type, purpose of loan, loan amount, loan terms, and type of collateral, as the denied loans sampled. For example, if the denied loan sample includes applications for lines of credit to cover inventory purchases for retail businesses, the examiner should select approved applications for lines of credit from retail businesses.

d. For each approved commercial loan application selected, complete a Small Business Loan Profile Spreadsheet, obtaining and recording information parallel to that obtained for denied applications, including the gender and race of the principals.

e. The examiner should first compare the **credit criteria** considered in the credit process for each of the approved and denied applications to established underwriting standards, rather than comparing files directly.

f. The examiner should identify any deviations from credit standards for both approved and denied credit requests, and differences in loan terms granted for approved credit requests.

g. The examiner should discuss each instance where deviations from credit standards and terms were noted, but were not explained in the file, with the commercial credit underwriter. Each discussion should be documented on an appropriate worksheet. (See **Workpaper Appendix**)

Step 3: Conduct Targeted Sampling

a. If deviations from credit standards or pricing are not sufficiently explained by other factors either documented in the credit file or the commercial underwriter was not able to provide a reasonable explanation, the examiner should determine if deviations were detrimental to any protected classes of applicants.

b. The examiner should consider employing the same techniques for determining race and gender characteristics of commercial applicants as those outlined in the consumer loan sampling procedures.

c. If it is determined that there are members of one or more prohibited basis groups among commercial credit requests that were not underwritten according to established standards or received less favorable terms, the examiner should select additional commercial loans, where applicants are members of the same prohibited basis group and select similarly situated control group credit requests. These additional files should be selected based on the specific applicant circumstance(s) that appeared to have been viewed differently by lending personnel on a prohibited basis.

d. If there are not enough similarly situated applicants for comparison in the original sample period to draw a reasonable conclusion, the examiner should expand the sample period. The expanded sample period should generally not go beyond the date of the prior examination.

<u>Sampling Guidelines</u>

a. Generally, the task of selecting an appropriate expanded sample of prohibited basis and control group applications for commercial loans will require examiner judgement. The examiner should select a sample that is large enough to be able to draw a reasonable conclusion.

b. The examiner should first select from the applications that were acted on during the initial sample period, but were not included in the initial sample, and select applications from prior time periods as necessary.

c. The expanded sample should include both approved and denied, prohibited basis and control group applications, where similar credit was requested by similar enterprises for similar purposes.

<u>F. Analysis of Potential Discriminatory “Redlining”.</u>

<u>Overview</u>: For purposes of this analysis, “redlining” is a form of illegal disparate treatment in which a lender provides unequal access to credit, or unequal terms of credit, because of the race, color, national origin, or other prohibited characteristic(s) of the residents of the area in which the credit seeker resides or will reside or in which the residential property to be mortgaged is located.

The redlining analysis may be applied to determine whether, on a prohibited basis:

- a lender fails or refuses to extend credit in such an area;
- a makes loans in such an area but at a restricted level or upon less-favorable terms or conditions as compared to contrasting areas; or
- a lender omits or excludes such an area from efforts to market residential loans or solicit customers for residential credit.

This guidance focuses on possible discrimination against racial or national origin minorities. The same analysis could be adapted to evaluate relative access to credit for areas of geographical concentration on other prohibited bases -- for example, age.

> **NOTE:** It is true that neither the Equal Credit Opportunity Act (ECOA) nor the Fair Housing Act (FH Act) specifically uses the term “redlining.” However, federal courts as well as agencies that have enforcement responsibilities for the FH Act, have interpreted it as prohibiting lenders from having different marketing or lending practices for certain geographic areas, compared to others, where the purpose or effect of such differences would be to discriminate on a prohibited ba-

sis. Similarly, the ECOA would prohibit treating applicants for credit differently on the basis of differences in the racial or ethnic composition of their respective neighborhoods.

Like other forms of disparate treatment, redlining can be proven by overt or comparative evidence. If any written or oral policy or statement of the lender (see risk factors R5, R6, and R7 in Part I, above) suggests that the lender links the racial or national origin character of an area with any aspect of access to or terms of credit, the examiners should refer to the guidance in section A of this Part III, on documenting and evaluating overt evidence of discrimination.

Overt evidence includes not only explicit statements, but also any geographical terms used by the lender that would, to a reasonable person familiar with the community in question, connote a specific racial or national origin character. For example, if the principal information conveyed by the phrase "north of 110th Street" is that the indicated area is principally occupied by Hispanics, then a policy of not making credit available "north of 110th Street" is overt evidence of potential redlining on the basis of national origin.

Overt evidence is relatively uncommon. Consequently, the redlining analysis usually will focus on comparative evidence (similar to analyses of possible disparate treatment of individual customers) in which the lender's treatment of areas with contrasting racial or national origin characters is compared.

When the scoping process (including consultation within an agency as called for by agency procedures) indicates that a redlining analysis should be initiated, examiners should complete the following steps of comparative analysis:

- Identify and delineate any areas within the lender's CRA assessment area or market area for residential products that are of a racial or national origin minority character;
- Determine whether any minority area identified in step 1 appears to be excluded, underserved, selectively excluded from marketing efforts, or otherwise less-favorably treated in any way by the lender;
- Identify and delineate any areas within the lender's CRA assessment area or market area for residential products that are nonminority in character and that the lender appears to treat more favorably;
- Obtain the lender's explanation for the apparent difference in treatment between the areas and evaluate whether it is credible and reasonable; and
- Obtain and evaluate other information that may support or contradict interpreting identified disparities to be the result of intentional illegal discrimination.

These steps are discussed in detail below.

Using information obtained during scoping

Although the five tasks listed are presented below as examination steps in the order given above, examiners should recognize that a different order may be preferable in any given examination. For example, the lender's explanation (step 4) for one of the policies or patterns in question may already be documented in the CRA materials reviewed (step 2) and the CRA examiners may already have verified it, which may be sufficient for purposes of the redlining analysis.

As another example, as part of the scoping process, the examiners may have reviewed an analysis of the geographic distribution of the lender's loan originations with respect to the racial and national origin composition of census tracts within its CRA assessment or residential market area. Such analysis might have documented the existence of significant discrepancies between areas, by degree of minority concentration, in loans originated (risk factor R1), approval/denial rates (risk factor R2) and/or rates of denials because of insufficient collateral (risk factor R3). In such a situation in which the scoping process has produced a reliable factual record, the examiners could begin with step 4 (obtaining an explanation) of the redlining analysis below.

In contrast, when the scoping process only yields partial or questionable information, or when the risk factors on which the redlining analysis is based are complaints or allegations against the lender, steps 1, 2, and/or 3 must be addressed.

Comparative analysis for redlining

Step 1: Identify and delineate any areas within the lender's CRA assessment area or market area for residential products that are of a racial or national origin minority character

> **NOTE**: The CRA assessment area can be a convenient unit for redlining analysis because information about it typically already is in hand. However, the CRA assessment area may be too limited. The redlining analysis focuses on the lender's decisions about how much access to credit to provide to different geographical areas. The areas for which those decisions can best be compared are areas where the lender actually marketed and provided credit and where it could reasonably be expected to have marketed and provided credit. Some of those areas might be beyond or otherwise different from the CRA assessment area.

If there are no areas identifiable for their racial or national origin minority character within the lender's CRA assessment area or market area for residential products, a redlining analysis is not appropriate. (If there is a substantial but *dispersed* minority population, potential disparate treatment can be evaluated by a routine comparative file review of applicants.)

This step may have been substantially completed during scoping, but unresolved matters may remain. (For example, several community spokespersons may allege that the lender is redlining, but disagree in defining the area.) The examiners should:

a. Describe as precisely as possible why a specific area is recognized in the community (perceptions of residents, etc.) and/or is objectively identifiable (based on census or other data) as having a particular racial or national origin minority character.

- The most obvious identifier is the predominant race or national origin of the residents of the area. Examiners should document the percentages of racial or national origin minorities residing within the census tracts that make up the area. However, they should bear in mind that it is illegal for the lender to consider a prohibited factor *in any way*. For example, an area might be only 20% black, but if a lender refuses to extend credit there because the lender believes the area is "changing to black," that too is a violation. Contacts with community groups can be helpful to learn whether there are such subtle features of racial or ethnic character.
- Geographical groupings that are convenient for CRA may obscure racial patterns. For example, an underserved, low-income, predominantly minority neighborhood that lies within a larger low-income area that primarily consisted of *non*minority neighborhoods, may seem adequately served when the entire low-income area is analyzed as a unit. However, a racial pattern of underservice to minority areas might be revealed if the low-income minority neighborhood shared a border with an underserved, *middle*-income, minority area and those two minority areas were grouped together for purposes of analysis. Review the analysis from prior CRA examinations of whether the assessment area appears to have been influenced by prohibited factors. If there are minority areas that the lender excluded from the assessment area improperly, consider whether they ought to be included in the redlining analysis.

b. Describe how the racial or national origin character changes across the suspected redlining area's various boundaries.

c. Document or estimate the amount, within the minority area, of types of housing for which the lender offers residential credit. If the minority area does not have a significant amount of such housing, the area is not appropriate for a redlining analysis.

Step 2: Determine whether any minority area identified in step 1 is excluded, under-served, selectively excluded from marketing efforts, or otherwise less-favorably treated in any way by the lender

The examiners should begin with the risk factors identified during the scoping process. The unfavorable treatment may have been substantially documented during scoping and needs only to be finished in this step. If not, this step will verify and measure the extent to which HMDA data show the minority areas identified in Step 1 to be under-served and/or how the lender's explicit policies treat them less favorably.

a. Review prior CRA lending test analyses to learn whether they have identified any excluded or otherwise under-served areas or other significant geographical disparities in the institution's lending. Determine whether any of those are the minority areas identified in Step 1.

b. Learn from the lender itself whether, as a matter of policy, it treats any separate or distinct geographical areas within its marketing or service area differently from other areas. This may have been done completely or partially during scoping analysis related to risk factors R5, R6, and R7. The differences in treatment can be in marketing, branch operations, appraisal practices, application processing, approval requirements, pricing, loan conditions, evaluation of collateral, or any other policy or practice materially related to access to credit. Determine whether any of those less-favored areas are the minority areas identified in step 1.

c. Obtain from the lender: (i) its reasons for such differences in policy, (ii) how the differences are implemented, and (iii) any specific conditions that must exist in an area for it to receive the particular treatment (more favorable or less favorable) that the lender has indicated.

Step 3: Identify and delineate any areas within the lender's CRA assessment area or market area for residential products that are nonminority in character and that the lender appears to treat more favorably.

To the extent not already completed during scoping:

a. Document the percentages of whites and of racial or national origin minorities residing within the census tract(s) that comprise(s) the *non*minority area

b. Document the nature of the housing stock in the area

c. Describe, to the extent known, how the lender's practices, policies, or its rate of lending change from less- to more-favorable as one leaves the minority area at its various boundaries (Examiners should be particularly attentive to instances in which the boundaries between favored and disfavored areas deviate from boundaries the lender would reasonably be expected to follow, such as political boundaries or transportation barriers)

d. Examiners should particularly consider whether, within a large area that is composed predominantly of racial or national origin minority households, there are enclaves that are predominantly *non*minority or whether, along the area's borders, there are irregularities where the *non*minority group is predominant. As part of the overall comparison, examiners should determine whether credit access within those small *non*minority areas differs from credit access in the larger minority area.

Step 4: Obtain the lender's explanation for the apparent difference in treatment between the areas and evaluate whether it is credible and reasonable

This step completes the comparative analysis by soliciting from the lender any additional information not yet considered by the examiners that might show that there is a nondiscriminatory explanation for the apparent disparate treatment based on race or ethnicity.

For each matter that requires explanation, provide the lender full information about what differences appear to exist in how it treats minority and nonminority areas, and how the examiners reached their preliminary conclusions at this stage of the analysis.

a. Evaluate whether the conditions identified by the lender in step 2 as justifying *more* favorable treatment pursuant to institutional *policy* existed in minority neighborhoods that did *not* receive the favorable treatment called for by institutional policy. If there are minority areas for which those conditions existed, ask the lender to explain why the areas were treated differently despite the similar conditions.

b. Evaluate whether the conditions identified by the lender in Step 2 as justifying *less* favorable treatment pursuant to institutional *policy* existed in *non*minority neighborhoods that received favorable treatment nevertheless. If there are *non*minority areas for which those conditions existed, ask the lender to explain why those areas were treated differently, despite the similar conditions.

c. Obtain explanations from the lender for any apparent differences in treatment observed by the examiners but not called for by the lender's policies

- If the lender's explanation cites any specific conditions in the nonminority area(s) to justify more favorable treatment, determine whether the minority area(s) identified in step 1 satisfied those conditions. If there are minority areas for which those conditions existed, ask the lender to explain why the areas were treated differently despite the similar conditions

- If the lender's explanation cites any specific conditions in the minority area(s) to justify less favorable treatment, determine whether the nonminority area(s) had those conditions. If there are *non*minority areas for which those conditions existed, ask the lender to explain why those areas were treated differently, despite the similar conditions.

d. Evaluate the lender's responses by applying appropriate principles selected from the **Appendix** on **Evaluating Responses to Evidence of Disparate Treatment**.

Step 5: Obtain and evaluate specific types of other information that may support or contradict interpreting identified disparities to be the result of intentional illegal discrimination

As a legal matter, discriminatory intent can be inferred simply from the lack of a legitimate explanation for clearly less-favorable treatment of racial or national origin minorities. That might be the situation after step 4. Nevertheless, if the lender's explanations do not adequately account for a documented difference in treatment, the examiners should consider additional information that might support or contradict the interpretation that the difference in treatment was intended.

a. <u>Comparative file review</u>. If there was a comparative file review conducted in conjunction with the redlining examination, review the results; or, if it is necessary and feasible to do so to clarify what appears to be discriminatory redlining, compare denied applications from within the suspected redlining area to approved applications from the contrasting area.

- Learn whether there were any denials of fully qualified applicants from the suspected redlining area. If so, that tends to support the view that the lender wanted to avoid doing business in the area.

- Learn whether the file review identified instances of illegal disparate treatment against applicants of the same race or national origin as the suspected redlining area. If so, that tends to support the view that the lender wanted to avoid doing business with applicants of that group, such as the residents of the suspected redlining area. Learn whether any such identified victims applied for transactions in the suspected redlining area.

- If there are instances of either of the above, identify denied *non*minority residents, if any, of the suspected redlining area and review their application files to learn whether they appear to have been treated in an irregular or less favorable way. If so, that tends to support the view that the character of the area rather than of the applicants themselves appears to have influenced the credit decisions.

- Review withdrawn and incomplete applications for the suspected redlining area, if those can readily be identified from the HMDA-LAR, and learn whether there are reliable indications that the lender discouraged those applicants from applying. If so, that tends to support the view that the lender did not want to do business in the area and may constitute evidence of a violation of Section 202.5(a) of Regulation B.

Conversely, if the comparisons of individual transactions show that the lender treated minority and nonminority applicants within and outside the suspected redlining area similarly, that tends to contradict the conclusion that the lender avoided the areas because it had minority residents.

b. Interviews of third parties. The perspectives of third parties will have been taken into account to some degree through the review of available materials during scoping. Later in the examination, in appropriate circumstances, information from third parties may help in interpreting whether the lender's apparent differences in treatment of minority and nonminority areas were intended.

  - Identify persons (such as housing or credit counselors, home improvement contractors, or real estate and mortgage brokers) who may have extensive experience dealing with credit applicants from the suspected redlined area.
  - After obtaining appropriate authorization and guidance from your agency, interview those persons to learn of their *first-hand experiences* related to:
  - oral statements or written indications by a lender's representatives that loan applications from a suspected redlined area were discouraged;
  - whether the lender treated applicants from the suspected redlining area as called for in its own procedures (as the examiners understand them) and/or whether it treated them similarly to applicants from nonminority areas (as the examiners are familiar with those transactions);
  - any unusual delays or irregularities in loan processing for transactions in the suspected redlining area;
  - differences in the lender's pricing, loan conditions, property valuation practices, etc., in the suspected redlining area compared to contrasting areas.

Also, learn from the third parties the names of any consumers they described as having experienced the questionable behavior recounted by the third party, and consider contacting those consumers.

If third parties witnessed specific conduct by the lender that indicates the lender wanted to avoid business from the area or prohibited basis group in question, this would tend to support interpreting the difference in treatment as intended. Conversely, if third parties report proper treatment or positive actions toward such area or prohibited basis group, this would tend to contradict the view that the lender intended to discriminate.

c. Marketing. A clear exclusion of the suspected redlining area from the lender's marketing of residential loan products supports the view that the lender did not want to do business in the area. Marketing decisions are affirmative acts to include or exclude areas. Disparities in marketing between two areas may reveal that the lender prefers one to the other. If sufficiently stark and supported by other evidence, a difference in marketing to racially different areas could itself be treated as a redlining violation of the Fair Housing Act. Even below that level of difference, marketing patterns can support or contradict the view that disparities in lending practices were intentional.

- Review materials that show how the lender has marketed in the suspected redlined area and in nonminority areas. Begin with available CRA materials and discuss the issues with CRA examiners, then review other materials as appropriate. The materials may include, for example, the lender's guidance for the geographical distribution of pre-approved solicitations for credit cards or home equity lines of credit, advertisements in local media or business or telephone directories, business development calls to real estate brokers, and calls by telemarketers.

d. Peer performance. Market share analysis and other comparisons to competitors are insufficient by themselves to prove that a lender engaged in illegal redlining. By the same token, a lender cannot justify its own failure to market or lend in an area by citing other lenders' failures to lend or market there.

However, a lender's inactivity in an underserved area where its acknowledged competitors are active would tend to support the interpretation that it intends to avoid doing business in the area. Conversely, if it is as active as other lenders, that would suggest that it intends to compete for, rather than avoid, business in the area.

- Develop a list of the institution's competitors.
- Learn the level of lending in the suspected redlining area by competitors. Check any public evaluations of similarly situated competitors obtained by the CRA examiners as part of evaluating the performance context or obtain such evaluations independently.

e. Institution's record. Request from the lender information about its overall record of serving or attempting to serve the racial or national origin minority group with which the suspected redlining area is identified. The record may reveal an intent to serve that group that tends to contradict the view that the lender intends to discriminate against the group.

Step 6. For any information that supports interpreting the situation as illegal discrimination, obtain and evaluate an explanation from the institution as called for in Part IV.

NOTE: If the lender's explanation is that the disparate results are the consequence of a specific, neutral policy or practice that the lender applies broadly, such as not making loans on homes below a certain value, review the guidance in the **Appendix** on **Disproportionate Adverse Impact** and consult agency managers.

G. Analysis of Potential Discriminatory Marketing Practices.

When scoping identifies significant risk factors (M1-M7) related to marketing, examiners should consult their managers and experts about a possible marketing discrimination analysis. If the managers agree to proceed, the examiners should collect information as follows:

Step 1: Identify the bank's marketing initiatives.

a. Pre-approved solicitations

- Determine whether the bank sends out pre-approved solicitations:
  - — for home purchase loans
  - — for home improvement loans
  - — for refinance loans
- Determine how the bank selects recipients for such solicitations
  - — learn from the bank its criteria for such selections
  - — review any guidance or other information the bank provided credit reporting companies or other companies that supply such lists

b. Media Usage

- Determine in which newspapers and broadcast media the bank advertises.
  - — identify any racial or national origin identity associated with those media
- Determine whether those media focus on geographical communities of a particular racial or national origin character
- Learn the bank's strategies for geographic and demographic distribution of advertisements.
- Obtain and review copies of the bank's printed advertising and promotional materials.

- Determine what criteria the bank communicates to media about what is an attractive customer or an attractive area to cultivate business.
- Determine whether advertising and marketing are the same to racial and national origin minority areas as compared to nonminority areas.

c. Self-produced promotional materials

- Learn how the bank distributes its own promotional materials, both methods and geographical distribution
- Learn what the bank regards as the target audience(s) for those materials

d. Realtors, brokers, contractors, and other intermediaries

- Determine whether the bank solicits business from specific realtors, brokers, home improvement contractors, and other conduits.
  - — learn how the bank decides which intermediaries it will solicit
  - — identify the parties contacted and determine the distribution between minority and nonminority areas
  - — obtain and review the types of information the bank distributes to intermediaries
  - — determine how often the bank contacts intermediaries
- Determine what criteria the bank communicates to intermediaries about the type of customers it seeks or the nature of the geographic areas in which it wishes to do business.

Step 2: Determine whether the bank's activities show a significantly lower level of marketing effort toward minority areas or toward media or intermediaries that tend to reach minority areas.

Step 3: If there is any such disparity, document the bank's explanation for it.

For additional guidance, refer to **Part C** of the **Special Analyses** section in the **Appendix**.

H. Credit Scoring.

If the scoping process results in the selection of a Focal Point that includes a credit or mortgage scored loan product, refer to **Part B** of the **Credit Scoring Analysis** section of the **Appendix**.

If the institution utilizes a credit scoring program which scores *age* for any loan product selected for review in the scoping stage, either as the sole underwriting determinant or only as a "guide" to making loan decisions, refer to **Part D** of the **Credit Scoring Analysis** section of the **Appendix**.

I. Disparate Impact Issues.

These procedures have thus far focused primarily on examining comparative evidence for possible unlawful *disparate treatment*. Disparate *impact* has been described briefly in the Introduction. Whenever an examiner believes that a particular policy or practice of a lender appears to have a *disparate impact* on a prohibited basis, the examiner should refer to Part A of the **Special Analyses** section of the **Appendix** or consult with agency managers for further guidance.

PART IV - OBTAINING AND EVALUATING RESPONSES FROM THE LENDER AND CONCLUDING THE EXAMINATION

Step 1. Present to the institution's management for explanation:

a. Any **overt** evidence of disparate treatment on a prohibited basis.

b. All instances of apparent **disparate treatment** (e.g., overlaps) in either the underwriting of loans or in loan prices, terms, or conditions.

c. All instances of apparent **disparate treatment** in the form of discriminatory steering, redlining, or marketing policies or practices.

d. All instances where a denied prohibited basis applicant was not afforded the same **level of**

assistance or the **same benefit of discretion** as an approved control group applicant who was no better qualified with regard to the reason for denial.

e. All instances where a prohibited basis applicant received **conspicuously** less favorable treatment by the lender than was **customary** from the lender or was **required** by the lender's policy.

f. Any statistically significant average difference in either the **frequency** or **amount of pricing disparities** between control group and prohibited basis group applicants.

g. Any evidence of neutral policies, procedures or practices that appear to have a **disparate impact or effect** on a prohibited basis.

Explain that unless there are legitimate, nondiscriminatory explanations (or in the case of disparate impact, a compelling business justification) for each of the preliminary findings of discrimination identified in this Part, the agency could conclude that the lender is in violation of the applicable fair lending laws.

Step 2. Document all responses that have been provided by the institution, not just its "best" or "final" response. Document each discussion with dates, names, titles, questions, responses, any information that supports or undercuts the lender's credibility, and any other information that bears on the issues raised in the discussion(s).

Step 3. Evaluate whether the responses are consistent with previous statements, information obtained from file review, documents, reasonable banking practices, and other sources, and satisfy common-sense standards of logic and credibility.

a. Do not speculate or assume that the institution's decision-maker had specific intentions or considerations in mind when he or she took the actions being evaluated. Do not, for example, conclude that because you have noticed a legitimate, nondiscriminatory reason for a denial (such as an applicant's credit weakness), that no discrimination occurred unless it is clear that, at the time of the denial, the lender actually based the denial on that reason.

b. Perform follow-up file reviews and comparative analyses, as necessary, to determine the accuracy and credibility of the lender's explanations.

c. Refer to **"Evaluating Responses to Evidence of Disparate Treatment"** in the **Appendix** for guidance as to common types of responses.

d. Refer to the **Disproportionate Adverse Impact** portion of the **"Special Analyses"** section of the **Appendix** for guidance on evaluating the institution's responses to apparent disparate impact.

Step 4. If, after completing steps 1. 3., above, you conclude that the institution has failed to adequately demonstrate that one or more apparent violations had a legitimate nondiscriminatory basis or were otherwise lawful, prepare a documented list or discussion of violations, or a draft examination report, as prescribed in the Workpapers Appendix or by agency directives.

Step 5. Consult with agency managers regarding whether (a) any violations should be referred to the Departments of Justice or Housing and Urban Development and (b) enforcement action should be undertaken by your agency.

Compliance Management Analysis Checklist -- 201A.2

Credit Scoring Analysis -- 201A.6

Evaluating Responses to Evidence of Disparate Treatment ----------------------------- 201A.9

Fair Lending Sample Size Tables -- 201A.14

Marginal Transactions -- 201A.16

Potential Scoping Information -- 201A.18

Special Analyses --- 201A.20

Streamlining the Examination -- 201A.23

Compliance Management Analysis Checklist

This checklist is for use in conjunction with Part II of these procedures as a device for evaluating the quality of preventive and corrective measures, identifying worthwhile innovations and offering suggestions for improvement. The checklist is not, however, intended to be an absolute test of a lender's compliance management program. Lender programs containing all or most of the features described in the list may nonetheless be flawed for other reasons; conversely, a compliance program which encompasses only a portion of the factors listed below may nonetheless adequately support a strong program under appropriate circumstances. In short, the examiner must exercise his or her best judgment in utilizing this list and in assessing the overall quality of a lender's efforts to ensure fair lending compliance.

If the transactions within the proposed scope are covered by a listed self-compliance measure, check the box in the left column. Reduce the intensity (mainly the sample size) of the planned comparative file review to the degree that the self-compliance measures cover transactions within the proposed scope. Document your findings in sufficient detail to justify any resulting reduction in the intensity of the examination.

You are not required to learn whether self-compliance measures apply to specific products outside the proposed scope. However, if the information you have obtained shows that the self-compliance measure is a general practice of the lender, check the box in the second column in order to assist future examination planning.

A. Preventive Measures

Determine whether policies and procedures exists that tend to prevent illegal disparate treatment in the transactions you plan to examine. There is no legal or agency requirement for institutions to conduct these activities. The absence of any of these policies and practices is never, by itself, a violation.

1. Lending practices and standards:

—Within the proposed scope.

—Lender-wide

a. Principal policy issues

☐ ☐ Are **underwriting practices** clear and similar to industry standards?

☐ ☐ Is **pricing** within reasonably confined ranges with guidance linking variations to risk and/or cost factors?

☐ ☐ Does management monitor the nature and frequency of **exceptions** to its standards?

☐ ☐ Are **denial reasons** accurately and promptly communicated to unsuccessful applicants?

NOTE: The items above are not compliance measures, but they are fundamental features of lending that tend to work against disparate treatment.

b. Do training, application-processing aids, and other guidance correctly and adequately describe:

☐ ☐ Prohibited bases under ECOA, Regulation B, and the Fair Housing Act?

☐ ☐ Other substantive credit access requirements of Regulation B (e.g., spousal signatures, improper inquiries, protected income?

c. Is it specifically **communicated to employees** that they must not, **on a prohibited basis:**

☐ ☐ Refuse to deal with individuals inquiring about credit?

☐ ☐ Discourage inquiries or applicants by delays, discourtesy, or other means?

☐ ☐ Provide different, incomplete, or misleading information about the availability of loans, application requirements, and processing and approval standards or procedures (including selectively informing applicants about certain loan products while failing to inform them of alternatives)?

☐ ☐ Encourage or more vigorously assist only certain inquirers or applicants?

☐ ☐ Refer credit seekers to other lenders?

☐ ☐ Waive or grant exceptions to application procedures or credit standards?

☐ ☐ State a willingness to negotiate?

☐ ☐ Use different procedures or standards to evaluate applications?

☐ ☐ Use different procedures to obtain and evaluate appraisals?

☐ ☐ Provide certain applicants opportunities to correct or explain adverse or inadequate information, or to provide additional information?

☐ ☐ Accept alternative proofs or creditworthiness?

☐ ☐ Require co-signers?

☐ ☐ Offer or authorize loan modifications?

☐ ☐ Suggest or permit loan assumptions?

☐ ☐ Impose late charges, reinstatement fees, etc.?

☐ ☐ Initiate collection or foreclosure?

d. Has the institution taken specific initiatives to **prevent forms of unintentional discrimination**, including:

☐ ☐ Basing credit decisions on assumptions derived from racial, gender, and other stereotypes, rather than facts?

☐ ☐ Seeking customers from a particular racial, ethnic, or religious group, or of a particular gender, to the exclusion of other types of customers, on the basis of how "comfortable" the employee may feel in dealing with those different from him/her?

☐ ☐ Because of their discomfort or unease in dealing with customers from certain racial, ethnic, or religious groups, or of a certain gender, limiting the exchange of credit-related information or their effort to qualify the applicant?

☐ ☐ Is the institution's CRA assessment area drawn without unreasonably excluding minority areas?

e. Does the institution have procedures to ensure that it does not:

☐ ☐ State racial or ethnic limitations in advertisements?

☐ ☐ Employ code words in advertisements that convey racial or ethnic limitations?

☐ ☐ Place advertisement that a reasonable person would regard as indicating minority customers are less desirable?

☐ ☐ Advertise only in media serving non-minority areas of the market?

☐ ☐ Conduct other forms of marketing only in non-minority areas of the market?

☐ ☐ Market only through brokers known to serve only one racial or ethnic group in the market?

☐ ☐ Use a prohibited basis in any pre-screened solicitation?

2. Compliance Audit Function: Does the Bank Attempt to Detect

Prohibited Disparate Treatment by Self-Evaluation?

> **NOTE**: Do not request the results of self-evaluations. The following items are intended to obtain information about the bank's approach for self-evaluation, not its findings. Evaluating the voluntarily disclosed results of self-evaluations is described in **Streamlining the Examination** in the **Appendix**.

Mark the box if the answer is "yes" for the transactions within the scope.

a. Are the transactions reviewed by an independent analyst who:

☐ ☐ Is directed to report objective results?

☐ ☐ Has an adequate level of expertise?

☐ ☐ Produces written conclusions?

b. Does the bank's approach for self-evaluation call for:

☐ ☐ Attempting to explain major patterns shown in the HMDA data?

☐ ☐ Determining whether actual practices and standards differ from stated ones and basing the evaluation on the actual practices?

☐ ☐ Evaluating whether the reasons cited for denial are supported by facts relied on by the decision maker at the time of the decision?

☐ ☐ Comparing the treatment of prohibited basis group applicants to control group applicants?

☐ ☐ Obtaining explanations from decision makers for any unfavorable treatment of the prohibited basis group that departed from policy or customary practice?

☐ ☐ Covering significant decision points in the loan process where disparate treatment might occur, including:

> The approve/deny decision?
> Pricing?
> Other terms and conditions?

☐ ☐ Covering at least as many transactions as examiners would independently, if using the OCC's "Fair Lending Sample Size Guide" for a product with the application volumes of the product to be evaluated?

c. In the bank's plan for comparing the treatment of prohibited basis group applicants with that of control group applicants:

☐ ☐ Are control and prohibited basis groups based on a prohibited basis found in ECOA or the FH Act and defined clearly to isolate that prohibited basis for analysis?

☐ ☐ Are appropriate data to be obtained to document treatment of applicants and the relative qualifications vis-a-vis the requirement in question?

☐ ☐ Are the data to be obtained the data on which decisions were based, not later or irrelevant information?

☐ ☐ Does the plan call for comparing the denied applicants' qualifications related to the stated reason for denial with the corresponding qualifications for approved applicants?

☐ ☐ Are comparisons designed to identify instances in which prohibited basis group applicants were treated less favorably than control group applicants who were no better qualified?

☐ ☐ Is the evaluation designed to determine whether control and prohibited basis group applicants were treated differently in the processes by which the bank helped applicants overcome obstacles and by which their qualifications were enhanced?

☐ ☐ Are responses and explanations to be obtained for any apparent disparate treatment on a prohibited basis or other apparent violations of credit rights?

☐ ☐ Are reasons cited by credit decision makers to justify or explain instances of apparent disparate treatment to be verified?

3. Correcting Discriminatory Conduct

a. Determine whether the lender has provisions to **take appropriate corrective action** and **provide adequate relief** to victims for any violations in the transactions you plan to review.

- Who is to receive the self-evaluation results?
- What decision process is supposed to follow delivery of the information?
- Is feedback to be given to staff whose actions are reviewed?
- What types of corrective action may occur?

☐ ☐ Offered credit if they were improperly denied?

☐ ☐ Compensated for any damages, both out of pocket and compensatory?

☐ ☐ Notified of their legal rights?

b. Other corrective action:

☐ ☐ Are institutional policies or procedures that may have contributed to the discrimination to be corrected?

☐ ☐ Are employees involved to be trained and/or disciplined?

☐ ☐ Is the need for community outreach programs and/or changes in marketing strategy or loan products to better serve minority segments of the lender's market to be considered?

☐ ☐ Are audit and oversight systems to be improved in order to ensure there is not recurrence of any identified discrimination?

Credit Scoring Analysis

These procedures are intended to assist an examiner in arriving at supportable conclusions with respect to an institution's record of non-discrimination when the Focal Point involves a product for which the institution uses automated underwriting or when credit scoring risk factors make such a product the Focal Point

A. Structure and Organization of the Scoring System

Determine the utilization of credit scoring at the institution including

1. For each customized credit scoring model or scorecard for any product, or for any credit scoring model used in connection with a product held in portfolio, identify:

   a. the number and inter-relationship of each model or card applied to a particular product,

   b. the purposes for which each card is employed (e.g., approval decision, set credit limits, set pricing, determine processing requirements, etc.)

   c. the developer of each card used (e.g., in-house department, affiliate, independent vendor name) and describe the development population utilized;

   d. the types of monitoring reports generated (including front-end, back-end, account management and any disparate impact analyses), the frequency of generation and recent copies of each;

   e. all policies applicable to the use of credit scoring;

   f. training materials and programs on credit scoring for employees, agents and brokers involved in any aspect of retail lending;

   g. any action taken to revalidate or re-calibrate any model or scorecard used during the exam period and the reason(s) why;

   h. the number of all high-side and low-side overrides for each type of override occurring during the exam period and any guidance given to employees on their ability to override;

   i. all cutoffs used for each scorecard throughout the examination period and the reasons for any change made during the exam period;

   j. all variables scored by each product's scorecard(s) and the values that each variable may take; and

   k. the method used to select for disclosure those adverse action reasons arising from application of the model or scorecard.

2. For each judgmental underwriting system that includes as an underwriting criteria a standard credit bureau or secondary market credit score identify:

   a. the vendor of each credit score and any vendor recommendation or guidance on the usage of the score relied upon by the institution.

   b. the institution's basis for using the particular bureau or secondary market score and the cutoff standards for each product's underwriting system and the reasons for any changes to the same during the exam period;

   c. the number of exceptions or overrides made to the credit score component of the underwriting criteria and the basis for those exceptions or overrides, including any guidance given to employees on their ability to depart from credit score underwriting standards, and;

   d. types of monitoring reports generated on the judgmental system or its credit scoring component (including front-end, back-end, differential processing **and disparate impact** analysis), the frequency of generation and recent copies of each.

B. Adverse Action Disclosure Notices

Determine the methodology used to select the reasons why adverse action was taken on a credit application denied on the basis of the applicant's credit score. Compare the methodology used to the examples recited in the Commentary to Regulation B and decide acceptability against that standard. Identify any consumer requests for reconsideration of credit score denial reasons and review the action taken by management for consistency across applicant groups.

Where a credit score is used to differentiate application processing, and an applicant is denied for failure to attain a judgmental underwriting standard that would not be applied if the applicant had received a better credit score (thereby being considered in a different—presumably less stringent--application processing group), ensure that the adverse action notice also discloses the bases on which the applicant failed to attain the credit score required for consideration in the less stringent processing group.

C. Disparate Treatment in the Application of Credit Scoring Programs

1. Determine what controls and policies management has implemented to ensure that the institution's credit scoring models or credit score criteria are not applied in a discriminatory manner; in particular:

   a. Examine institution guidance on using the credit scoring system, on handling overrides and on processing applicants and how well that guidance is understood and observed by the targeted employees and monitored for compliance by management

   b. Examine institution policies that permit overrides or that provide for different processing or underwriting requirements based on **geographic identifiers** or **borrower score ranges** to assure that they do not treat protected group applicants differently than other similarly situated applicants.

2. Evaluate whether any of the bases for granting credit to control group applicants who are low-side overrides are applicable to any prohibited basis denials whose credit score was equal to or greater than the lowest score among the low-side overrides. If such cases are identified, obtain and evaluate management's reason for why such different treatment is not a fair lending violation.

3. Evaluate whether any of the bases for denying credit to any prohibited basis applicants who are high side overrides are applicable to any control group approvals whose credit score was equal to or less than the highest score among the prohibited basis high-side overrides. If such cases are identified, obtain and evaluate management's reason for why such different treatment is not a fair lending violation.

4. If credit scores are used to segment applicants into groups that receive different processing or are required to meet additional underwriting requirements (e.g., "tiered risk underwriting"), perform a comparative file review, or confirm the results and adequacy of management's comparative file review, that evaluates whether all applicants within each group are treated equally.

D. Credit Scoring Systems that Include Age

Regulation B imposes certain requirements on credit scoring systems that include age as a variable in the determination of creditworthiness. This examination section applies only to credit scoring systems that consider age.

Age is considered in a credit scoring system either (a) when it is explicitly included as a variable in the items scored by the system, or (b) when the population is segmented into more than two groups that are separated by the age of the members and each group is then separately scored.

1. Age as an Explicit Variable.

a. When age is an explicit variable, the examiner must first determine whether § 202.6(b)(2)(ii) is met by the system. A credit scoring system meets this regulatory requirement when it assigns applicants age 62 or older the same or higher number of points for their age as are assigned to the most favored age (or age group) among all other applicants less than 62 years old. If the system fails this requirement, then, even if it is empirically derived and statistically sound, it still violates Regulation B. For purposes of assessing the degree of damage caused by the violation, the examiner should obtain a count of the number of applicants age 62 or older who, but for the difference in the score received for age as compared to the age (or age group) most favored by the system, (i) would have received credit, (ii) received credit on terms other than those for which they applied, or (iii) received credit on terms less favorable than which they would otherwise have qualified.

b. If the system examined assigns applicants age 62 or older a value for “age” that is equal to or greater than the value assigned to any other age or age group and the values assigned to the variable “age” for all applicants under age 62 is the same, then the system is permissible without further analysis. This conclusion results from the fact that even if the system was not empirically derived and demonstrably and statistically sound, age is only being used to favor the elderly and accordingly is permissible under § 202.6(b)(2)(iv). Therefore, it is immaterial to the examiner whether the system is an empirically derived, demonstrably and statistically sound credit scoring system or is a judgmental system.

c. If the system assigns applicants age 62 or older a value for “age” that is equal to or greater than the value assigned to any age or age group less than 62, but among applicants less than 62 the values for “age” are not equal, then the system must be empirically derived, demonstrably and statistically sound. To examine for these properties, the examiner should consult the agency’s most recent guidance on that issue.

2. Age-split Scorecards

The commentary to Regulation B declares that a creditor may segment the population of applicants into scorecards based on the age of an applicant. When a system uses a card covering a wide age range that encompasses elderly applicants, the credit scoring system does not score age. But if a system segments the population by age into multiple scorecards, and includes elderly applicants in a narrower age range, the credit scoring system does score age. For those systems falling into the first category of being deemed as not scoring age, there is no obligation to conduct a review for empirical derivation and statistical soundness.

If age-split scorecards are deemed to score age, they must be empirically derived, demonstrably and statistically sound, and must treat persons 62 or older at least as favorably as any other age group.

E. Examination for Empirical Derivation and Statistical Soundness

Regulation B requires credit scoring systems that use age to be empirically derived, *and* demonstrably and statistically sound. This means that they must fulfill the requirements of § 202.2(p)(1)(i) - (iv). Obtain documentation provided by the developer of the system and consult the agency’s most recent guidance for making that determination.

Evaluating Responses to Evidence of Disparate Treatment

A. Responses to Comparative Evidence of Disparate Treatment

The following are responses that a lender may offer -- separately or in combination -- to attempt to explain that the appearance of illegal disparate treatment is misleading, and that no violation has in fact occurred. The responses, **if true**, rebut the appearance of disparate treatment. The examiners must evaluate the validity and credibility of the responses.

1. The lender's personnel were unaware of the prohibited basis identity of the applicant(s).

If the lender claims to have been unaware of the prohibited basis identity (race, etc.) of an applicant or neighborhood, ask it to show that the application in question was processed in such a way that the institution's staff who made the decisions could not have learned the prohibited basis identity of the applicant.

If the product is one for which the institution maintains prohibited basis monitoring information, assume that all employees could have taken those facts into account. Assume the same when there was face-to-face contact between any employee and the customer.

If there are other facts about the application from which an ordinary person would have recognized the applicant's prohibited basis identity (for example, the surname is an easily recognizable Hispanic one), assume that the institution's staff drew the same conclusions. If the racial character of a community is in question, ask the institution to provide persuasive evidence why its staff would **not** know the racial character of any community in its service area.

2. The difference in treatment was justified by differences in the applicants (applicants not "similarly situated")

Ask the lender to account for the difference in treatment by pointing out a specific difference between the applicants' qualifications, or some factor not captured in the application but that legitimately makes one applicant more or less attractive to the lender, or some non-prohibited factor related to the processing of their applications. The difference identified by the lender must be one that is important enough to justify the difference in treatment in question, not a meaningless difference.

The factors commonly cited to show *that* applicants are not similarly situated fall into two groups: those that can be evaluated by how consistently they are handled in other transactions, and those that cannot be evaluated in that way.

a. Verifying "not similarly situated" explanations by consistency

The appearance of disparate treatment remains if a factor cited by the lender to justify favorable treatment for a control group applicant also exists for an otherwise similar prohibited basis applicant who was treated **un**favorably. Similarly, the appearance of disparate treatment remains if a factor cited by the lender to justify **un**favorable treatment for a prohibited basis applicant also exists for a control group applicants that got favorable treatment. If this is not so, ask the lender to document that the factor cited in its explanation was used consistently for control group and prohibited basis applicants.

Among the responses that should be evaluated this way are:

- **Customer relationship.** Ask the lender to document that a customer relationship was also sometimes considered to the benefit of prohibited basis applicants and/or that its absence worked against control group customers.

- **"Loan not saleable or insurable."** If file review is still in progress, be alert for loans approved despite the claimed fatal problem. At a minimum, ask the lender to be able to produce the text of the secondary market or insurer's requirement in question.

- **Difference in standards or procedures between branches or underwriters.** Ask the lender to provide transactions documenting that each of the two branches or underwriters applied its standards or procedures consistently to both prohibited basis and control group applications it processed, and that each served similar proportions of the prohibited basis group.

- Difference in applying the same standard (difference in "strictness") between underwriter, branches, etc. Ask the lender to provide transactions documenting that the stricter employee, branch, etc., was strict for both prohibited basis and control group applicants and that the other was lenient for both, and that each served similar proportions of the prohibited basis group. The best evidence of this would be prohibited basis applicants who received favorable treatment from the lenient branch and control group applicants who received less favorable treatment from the "strict" branch.

- **Standards or procedures changed during period reviewed.** Ask the lender to provide transactions documenting that during each period the standards were applied consistently to both prohibited basis and control group applicants.

- **Employee misunderstood standard or procedure.** Ask the lender to provide transactions documenting that the misunderstanding influenced both prohibited basis and control group applications. If that is not available, find no violation if the misunderstanding is a reasonable mistake.

b. Evaluating "not similarly situated" explanations by other means.

If consistency cannot be evaluated, *consider* an explanation *favorably* even without examples of its consistent use if:

- the factor is documented to exist in (or be absent from) the transactions, as claimed by the institution;

- the factor is one a prudent lender would consider;

- file review found no evidence that the factor is applied selectively on a prohibited basis (in other words, the lender's explanation is "not inconsistent with available information"); and

- the lender's description of the transaction is generally consistent and reasonable.

Some factors that may be impossible to compare for consistency are:

- **Unusual underwriting standard.** Ask the lender to show that the standard is prudent. If the standard is prudent and not inconsistent with other information, accept this explanation even though there is no documentation that it is used consistently.

- **"Close calls."** The lender may claim that underwriters' opposite decisions on similar applicants reflects legitimate discretion that the examiners should not second guess. That is **not** an acceptable explanation for **identical** applicants with different results, but is acceptable when the applicants have differing strengths and weaknesses that different underwriters might reasonably weigh differently. However, do not accept the explanation if other files reveal that these "strengths" or "weaknesses" are counted or ignored selectively on a prohibited basis.

- **"Character loan."** Expect the lender to identify a specific history or specific facts that make the applicant treated favorably a better risk than those treated less favorably.

- **"Accommodation loan."** There are many legitimate reasons that may make a transaction appealing to a lender apart from the familiar qualifications demanded by the secondary market and insurers. For example, a customer may be related to or referred by an important customer, be a political or entertainment figure who would bring prestige to the institution, be an employee of an important business customer, etc. It is not illegal discrimination to make a loan to an otherwise unqualified control group applicant who has such attributes while denying a loan to an otherwise similar prohibited basis applicant without them. However, be skeptical when the lender cites reasons for "accommodations" that an ordinary prudent lender would not value.

- **"Gut feeling."** Be skeptical when lenders justify an approval or denial by a general perception or reaction to the customer. Such a perception or reaction may be linked to a racial or other stereotype that legally must not influence credit decisions. Ask whether any specific event or fact generated the reaction. Often, the lender can cite something **specific** that made him or her confident or uncomfortable about the customer. There is no discrimination if it is credible that the lender indeed considered such a factor and did not apply it selectively on a prohibited basis.

c. Follow up customer contacts

If the lender's explanation of the handling of a particular transaction is based on customer traits, actions, or desires not evident from the file, consider *obtaining agency authorization to* contact the customer to verify the lender's description. Such contacts need not be limited to possible victims of discrimination, but can include *control group applicants* or other witnesses.

3. <u>The different results stemmed from an inadvertent error.</u>

If the lender claims an **identified error** such as miscalculation or misunderstanding caused the favorable or unfavorable result in question, evaluate whether the facts support the assertion that such an event occurred.

If the lender claims an **"unidentified error"** caused the favorable or unfavorable result in question, expect the lender to provide evidence that discrimination is inconsistent with its demonstrated conduct, and therefore that discrimination is the less logical interpretation of the situation. Consider the context (as described below).

4. <u>The apparent disparate treatment on a prohibited basis is a misleading portion of a larger pattern of random inconsistencies.</u>

Ask the institution to provide evidence that the unfavorable treatment is not limited to the prohibited basis group and that the favorable treatment is not limited to the control group. Without such examples, do not accept a lender's unsupported claim that otherwise inexplicable differences in treatment are distributed randomly.

If the lender can document that similarly situated prohibited basis applicants received the favorable treatment in question approximately **as frequently** and **in comparable degree** as the control group applicants, conclude there is no violation.

NOTE: Transactions are relevant to "random inconsistency" only if they are "similarly situated" to those apparently treated unequally.

5. <u>Loan terms and conditions</u>.

The same analyses described in the preceding sections with regard to decisions to approve or deny loans also apply to pricing differences. Risks and costs are legitimate considerations in setting prices and other terms and conditions of loan products. However, generalized reference by the lender to "cost factors" is insufficient to explain pricing differences.

If the lender claims that specific borrowers received different terms or conditions because of **cost or risk considerations**, ask the lender to be able to identify specific risk or cost differences between them.

If the lender claims that specific borrowers received different terms or conditions because they were **not similarly situated as negotiators**, consider whether application records might provide relevant evidence. If the records are not helpful, consider seeking authorization to contact customers to learn whether the lender in fact behaved comparably toward prohibited basis and control group customers. The contacts would be to learn such information as the lender's opening quote of terms to the customer and the progress of the negotiations.

If the institution responds that an average price difference between the control and prohibited basis groups is based on cost or risk factors, ask it to identify specific risk or cost differences between individual control group applicants with the lowest rates and prohibited basis group applicants with the highest that are significant enough to justify the pricing differences between them. If the distinguishing factors cited by the institution are legitimate and verifiable as described in the sections above, remove those applications from the average price calculation. If the average prices for the remaining control group and prohibited basis group members still differ more than minimally, consult within the agency about obtaining an analysis of whether the difference is statistically significant. Find a violation only if (1) there is evidence of disparate treatment of similarly situated borrowers or (2) there is a particular risk factor that meets all the criteria for a disproportionate adverse impact violation.

B. Responses to Overt Evidence of Disparate Treatment

1. Descriptive references vs. lending considerations

A reference to race, gender, etc., does not constitute a violation if it is merely descriptive -- for example, "the applicant was young." In contrast, when the reference reveals that the prohibited factor influenced the lender's decisions and/or customer behavior, treat the situation as an apparent violation to which the lender must respond.

2. Personal opinions vs. lending considerations

If an employee involved with credit availability states unfavorable views regarding a racial group, gender, etc., but does not explicitly relate those views to credit decisions, review that employee's credit decisions for possible disparate treatment of the prohibited basis group described unfavorably. If there are no instances of apparent disparate treatment, treat the employee's views as permissible private opinions. Inform the lender that such views create a risk of future violations.

3. Stereotypes related to credit decisions

There is an apparent violation when a prohibited factor influences a credit decision through a stereotype related to creditworthiness, even if the action based on the stereotype seems well-intended -- for example, a loan denial because "a single woman could not maintain a large house." If the stereotyped beliefs are offered as "explanations" for unfavorable treatment, regard such unfavorable treatment as apparent illegal disparate treatment. If the stereotype is only a general observation unrelated to particular transactions, review that employee's credit decisions for possible disparate treatment of the prohibited basis group in question. Inform the lender that such views create a risk of future violations.

4. Indirect reference to a prohibited factor

If negative views related to creditworthiness are described in non-prohibited terms, consider whether the terms would commonly be understood as surrogates for prohibited terms. If so, treat the situation as if explicit prohibited basis terms were used. For example, a lender's statement that "It's too risky to lend north of 110th Street" might be reasonably interpreted as a refusal to lend because of race if that portion of the lender's lending area north of 110th Street were predominantly black and the area south white.

5. Lawful use of a prohibited factor

a. Special Purpose Credit Program (SPCP)

If a lender claims that its use of a prohibited factor is lawful because it is operating an SPCP, ask the lender to document that its program conforms to the requirements of Regulation B. An SPCP must be defined in a written plan that existed before the lender made any decisions on loan applications under the program. The written plan must:

- demonstrate that the program will benefit persons who would otherwise be denied credit or receive credit on less favorable terms; and
- state the time period the program will be in effect or when it will be re-evaluated.

No provision of an SPCP should deprive people who are not part of the target group of rights or opportunities they otherwise would have. Qualified programs operating on an otherwise-prohibited basis will not be cited as a violation.

NOTE: Advise the lender that an agency finding that a program is a lawful SPCP is not absolute security against legal challenge by private parties. Suggest that an institution concerned about legal challenge from other quarters use exclusions or limitations that are not prohibited by ECOA or the FHAct, such as "first-time home buyer."

b. Second review program

Such programs are permissible if they do no more than ensure that lending standards are applied fairly and uniformly to all applicants. For example, it is permissible to review the proposed denial of applicants who are members of a *prohibited basis group*s by comparing their applications to the approved applications of similarly qualified individuals who are *in the control group* to determine if the applications were evaluated consistently.

Ask the lender to demonstrate that the program is a safety net that merely attempts to prevent discrimination, and does not involve underwriting terms or practices that are preferential on a prohibited basis.

Statements indicating that the mission of the program is to apply different standards or efforts on behalf of a particular racial or other group constitute overt evidence of disparate treatment. Similarly, there is an apparent violation if comparative analysis of applicants who are processed through the second review and those who are not discloses dual standards related to the prohibited basis.

c. Affirmative marketing/advertising program:

Affirmative advertising and marketing efforts that do not involve application of different lending standards are permissible under both the ECOA and the FH Act. For example, special outreach to a minority community would be permissible.

Fair Lending Sample Size Tables

Table A
Underwriting (Accept/Deny) Comparisons

Sample 1 — Prohibited Basis Denials | **Sample 2 — Control Group Approvals**

Number of Denials or Approvals	5 - 50	51 - 150	> 150		20 - 50	51 – 250	> 250
Minimum to review:	All	51	75		20	51	100
Maximum to review:	50	100	150		5x prohibited basis sample (up to 50)	5xprohibited basis sample (up to 125)	5x prohibited basis sample (up to 300)

Table B
Terms and Conditions Comparisons

Sample 1 — Prohibited Basis Approvals | **Sample 2 — Control Group Approvals**

Number of Approvals	5-25	26 - 100	> 100		20 -50	51 – 250	> 250
Minimum to review:	All	26	50		20	40	60
Maximum to review:	25	50	75		5x prohibited basis sample (up to 50)	5x prohibited basis sample (up to 75)	5x prohibited basis sample (up to 100)

See Explanatory Notes on following page.

Explanatory Notes to Sample Size Tables

1. When performing both underwriting and terms and conditions comparisons, use the same control group approval sample for both tasks.

2. If there are fewer than 5 prohibited basis denials or 20 control group approvals, refer to "Sample Size" instructions in the procedures.

3. "Minimum" and "maximum" sample sizes: select a sample size between the minimum and maximum based on the outcome of the Compliance Management Review conducted in Part II of these procedures. Once the sample size has been determined, select individual transactions judgmentally. Refer to procedures.

4. If two prohibited basis groups (e.g., black and Hispanic) are being compared against one control group, select a control group that is 5 times greater than the larger prohibited basis group sample, up to the maximum.

5. Where the institution's discrimination risk profile identifies significant discrepancies in withdrawal/incomplete activity between control and prohibited basis groups, or where the number of marginal prohibited basis group files available for sampling is small, an examiner may consider supplementing samples by applying the following rules:

   - If prohibited basis group withdrawals/incompletes occur after the applicant has received an offer of credit that includes pricing terms, this is a reporting error under Regulation C (the lender should have reported the application as approved but not accepted) and therefore these applications should be included as prohibited basis group approvals in a terms and conditions comparative file analysis.

   - If prohibited basis group incompletes occur due to lack of an applicant response with respect to an item that would give rise to a denial reason, then include them as denials for that reason when conducting an underwriting comparative file analysis.

Marginal Transactions

A. Marginal Denials

Denied applications with any or all the following characteristics are "marginal." Such denials are compared to marginal approved applications. Marginal applications include those that:

- Were close to satisfying the requirement that the adverse action notice said was the reason for denial;
- Were denied by the lender's rigid interpretation of inconsequential processing requirements;
- Were denied quickly for a reason that normally would take a longer time for an underwriter to evaluate;
- Involved an unfavorable subjective evaluation of facts that another person might reasonably have interpreted more favorably (for example, whether late payments actually showed a "pattern," or whether an explanation for a break in employment was "credible");
- Resulted from the lender's failure to take reasonable steps to obtain necessary information.
- Received unfavorable treatment as the result of a departure from customary practices or stated policies. For example, if it is the lender's stated policy to request an explanation of derogatory credit information, a failure to do so for a prohibited basis applicant would be a departure from customary practices or stated policies even if the derogatory information seems to be egregious;
- Were similar to an approved control group applicant who received unusual consideration or service, buy were not provided such consideration or service;
- Received unfavorable treatment (for example, were denied or given various conditions or more processing obstacles) but appeared fully to meet the lender's stated requirements for favorable treatment (for example, approval on the terms sought);
- Received unfavorable treatment related to a policy or practice that was vague, and/or the file lacked documentation on the applicant's qualifications related to the reason for denial or other factor.
- Met common secondary market or industry standards even though failing to meet the lender's more rigid standards;
- Had a strength that a prudent lender might believe outweighed the weaknesses cited as the basis for denial;
- Had a history of previously meeting a monthly housing obligation equivalent to or higher than the proposed debt; and/or
- Were denied for an apparently "serious" deficiency that might easily have been overcome. For example, an applicant's total debt ratio of 50 percent might appear grossly to exceed the lenders guideline of 36 percent, but this may in fact be easily corrected if the application lists assets to pay off sufficient nonhousing debts to reduce the ratio to the guideline, or if the lender were to count excluded part-time earnings described in the application.

B. Marginal Approvals

Approved applications with any or all of the following characteristics are "marginal." Such approvals are compared to marginal denied approved applications. Marginal approvals include those:

- Whose qualifications satisfied the lender's stated standard, but very narrowly;
- That bypassed stated processing requirements (such as verifications or deadlines);
- For which stated creditworthiness requirements were relaxed or waived;
- That, if the lender's own standards are not clear, fell short of common secondary market or industry lending standards;

- That a prudent conservative lender might have denied;
- Whose qualifications were raised to a qualifying level by assistance, proposals, counteroffers, favorable characterizations or questionable qualifications, etc.; and/or
- That in any way received unusual service or consideration that facilitated obtaining the credit.

Potential Scoping Information

This Appendix offers a full range of documentation and other information that might conceivably be brought to bear in an examination. In that sense, it is a ”menu” of resources to be considered and selected from, depending on the nature and scope of the examination being conducted. Any decision to select one or more particular items from this Appendix for inclusion in a particular examination should, of course, include consideration of any burdens to the agency and lender in assembling and providing the selected item(s).

A. Internal Agency Documents and Records.

1. Previous examination reports and related workpapers for the most recent Compliance / CRA and Safety and Soundness Examinations.

2. Demographic data for the institution's community**.**

   Comment: The examiner should obtain the most recent agency demographic data, for information on the characteristics of the institution’s assessment/market areas.

B. Information from the institution.

Comment: Prior to beginning a compliance examination, the examiner should request the institution to provide the information outlined below. This request should be made far enough in advance of the on-site phase of the examination to facilitate compliance by the institution. In some institutions, the examiner may not be able to review certain of this information until the on-site examination.

1. Institution's Compliance Program. (For examinations that will include analysis of the lender’s compliance program.)

a. Organization charts identifying those individuals who have lending responsibilities or compliance, HMDA or CRA responsibilities, together with job descriptions for each such position.

b. Lists of any pending litigation or administrative proceedings concerning fair lending matters.

c. To the degree that your agency’s policy permits you to solicit and utilize the results of self-evaluations, copies of audit or compliance reviews of the institution's program for compliance with fair lending laws and regulations, including both internal and independent audits.

NOTE: The request should advise the lender that it is not required to disclose whether it has engaged in self-testing programs of the type protected under amendments to ECOA and the FH Act nor the results of such programs.

d. Complaint file.

e. Any written or printed statements describing the lender’s fair lending policies and/or procedures.

f. Training materials related to fair lending issues including records of attendance.

2. Lending Policies / Loan Volume.

a. Internal underwriting guidelines and lending policies for all consumer and commercial loan products.

   Comment: If guidelines or policies differ by branch or other geographic location, request copies of each variation.

b. A description of any credit scoring system(s) in use now or during the exam period.

   Comment: Inquire as to whether a vendor or in-house system is used; the date of the last verification; the factors relied on to construct any in-house system and, if applicable, any judgmental criteria used in conjunction with the scoring system.

c. Pricing policies for each loan product, and for both direct and indirect loans.

Comment: The lender should be specifically asked whether its pricing policies for any loan products include the use of **"overages"**. The request should also ask whether the lender offers any **"sub-prime"** loan products for "B", "C" or "D" risk level customers or otherwise uses any form of **risk-based pricing**. A similar inquiry should be made regarding the use of any **cost-based pricing**. If any of these three forms are or have been in use since the last exam, the lender should provide pricing policy and practice details for each affected product, including the lender's criteria for differentiating between each risk *or cost* level. Regarding **indirect lending**, the lender should be asked to provide any forms of agreement *(including compensation)* with brokers/dealers, together with a description of the roles that both the lender and the dealer/broker play in **each stage** of the lending process.

d. A description of each form of compensation plan for all lending personnel and managers.

e. Advertising copy for all loan products.

f. The most recent HMDA / LAR, including unreported data if available. Information should be provided on diskette if possible.

Comment: The integrity of the institution's HMDA / LAR data should be verified prior to the pre-examination analysis. Verification should take place approximately two to three months prior to the on-site phase of the examination.

g. Any existing loan registers for each non-HMDA loan product.

Comment: Loan registers for the 3 month period preceding the date of the examination, together with any available lists of declined loan applicants for the same period should be requested. Registers / lists should contain, to the extent *available*, the complete name and address of loan applicants and applicable loan terms, including loan amount, interest rate, fees, repayment schedule and collateral codes.

h. A description of any data bases maintained for each loan product, including a description of all data fields within the database.

i. Forms used in the application and credit evaluation process for each loan product.

Comment: At a minimum, this request should include all types of credit applications, forms requesting financial information, underwriter worksheets, any form used for the collection of monitoring information, and any quality control or second review forms or worksheets.

j. Lists of service providers.

Comment: Service providers may include: realtors, real estate developers, appraisers, home improvement contractors and private mortgage insurance companies. Request the full name and address and geographic area served by each provider. Also request documentation as to any fair lending requirements imposed on, or commitments required of, any of the lender's service providers.

k. Addresses of any Internet Site(s)

Comment: Internet "Home Pages" or similar sites that a lender may install on the Internet may provide information concerning the availability of credit, or means for obtaining it. All such information would have to comply with the nondiscrimination requirements of the fair lending laws. Moreover, future enhancements to the Internet may include the capacity to conduct partial or complete credit transactions via that medium. Accordingly, it is important for examiners to review a lender's Internet sites to ensure that all of the information or procedures set forth therein are in compliance with any applicable provisions of the fair lending statutes and regulations.

3. Community Information.

a. Demographic information prepared or used by the institution.

b. Any fair lending complaints received and lender responses thereto.

Special Analyses

- Disproportionate Adverse Impact
- Pre-Application Screening
- Marketing

A. Disproportionate Adverse Impact Violations

When all five conditions below exist, consult within your agency whether to present the situation to the lender and solicit an explanation of the lender's business justification for the policy or criterion that appears to cause the disproportionate adverse impact. Note that condition 5 can be satisfied by **either** of two alternatives.

The contacts between examiners and lenders described in this section are information-gathering contacts within the context of the examination and are not intended to serve as the formal notices and opportunities for response that an agency's enforcement process might provide. Also, the five conditions are not intended as authoritative statements of the legal elements of a disproportionate adverse impact proof of discrimination; they are paraphrases intended to give examiners practical guidance on situations that call for more scrutiny and on what additional information is relevant.

> **NOTE**: Even if it appears likely that a policy or criterion causes a disproportionate adverse impact on a prohibited basis (condition 3), do not proceed with this analysis if the policy or criterion is obviously related to predicting creditworthiness or to some other basic aspect of prudent lending, and there appears to be no equally effective alternative for it. Examples are reliance on credit reports or use of debt-to-income ratio.

Conditions

1. A specific policy or criterion is involved.

The policy or criterion suspected of producing a disproportionate adverse impact on a prohibited basis must be clear enough that the nature of action to correct the situation can be determined.

> **NOTE**: Gross HMDA denial or approval rate disparities are not appropriate for disproportionate adverse impact analysis because they typically cannot be attributed to a specific policy or criterion. Similarly, a lender's policies of allowing employees to exercise discretion and to negotiate terms or conditions of credit can better be described as the **absence** of policies or criteria than as a situation in which a policy or criterion generates a disproportionate adverse impact. Broad discretion and vague standards raise concerns about discrimination, but examiners should focus on possible disparate **treatment**.

2. The policy or criterion on its stated terms is neutral for prohibited bases.

3. The disparity on a prohibited basis is significant.

The difference between the rate at which prohibited basis group members are harmed or excluded by the policy or criterion and the rate for control group members must be large enough that it is unlikely that it could have occurred by chance. If there is reason to suspect a significant disproportionate adverse impact may exist, consult the supervisory office, compliance manager, district counsel, and/or compliance management department, as appropriate.

4. There is a causal relationship between the policy or criterion and the adverse result.

The link between the policy or criterion and the harmful or exclusionary effect must not be speculative. It must be clear that changing or terminating the policy or criterion would reduce the disproportion in the adverse result.

5. **Either** *a* or *b*:

a. The policy or criterion has no clear rationale, or appears to exist merely for convenience or to avoid a minimal expense, or is far removed from common sense or standard industry underwriting considerations or lending practices.

The legal doctrine of disproportionate adverse impact says that the policy or criterion that causes the impact must be justified by "business necessity" if the lender is to avoid a violation. There is very little authoritative legal interpretation of that term with regard to lending, but that should not stop examiners from making the preliminary inquiries called for in these procedures. For example, the rationale is not clear for basing credit decisions on factors such as location of residence, income level (*per se* rather than relative to debt), and accounts with a finance company. If black applicants were denied loans significantly more frequently than white ones because they failed a lender's minimum income requirement, it would appear that the first four conditions plus 5a existed; therefore, the examiners should consult within their agency about obtaining the lender's response, as described in the next section below.

b. **Alternatively**, even if there is a sound justification for the policy, it appears that there may be an equally effective alternative for accomplishing the same objective with a smaller disproportionate adverse impact.

The law does not require a lender to abandon a policy or criterion that is clearly the most effective method of accomplishing a business objective. However, if an alternative that is approximately equally effective is available that would cause a less-severe impact, the policy or criterion in question will be a violation.

At any stage of the analysis of possible disproportionate adverse impact, if there appears to be such an alternative, and the first four conditions exist, consult within the agency how to evaluate whether the alternative would be equally effective and would cause a less-severe impact. If the conclusion is that it would, solicit a response from the lender, as described in the next section below.

Obtaining the lender's response

If the first four conditions plus either 5a or 5b appear to exist, consult within your agency about whether and how to inform the lender of the situation and solicit the lender's business justification. The communication with the lender should explain:

- The specific neutral policy or criterion that appears to cause a disproportionate adverse impact.
- How the examiners learned about the policy.
- How widely the examiners understand it to be implemented.
- How strictly they understand it to be applied.
- The prohibited basis on which the impact occurs.
- The magnitude of the impact.
- The nature of the injury to individuals
- The data from which the impact was computed.

The communication should state that no violation exists if the policy or criterion is used because of business necessity *and* there is no alternative that would accomplish the lender's objective with a smaller disproportionate adverse impact. It should inform the lender that cost and profitability are factors the agency will consider in evaluating the lender's business necessity. It should ask the lender to describe any alternatives it considered before adopting the policy or criterion at issue.

Evaluating and following up on the response

The analyses of "business necessity" and "less discriminatory alternative" tend to converge because of the close relationship of the questions of what purpose the policy or criterion serves and whether it is the most effective means to accomplish that purpose.

Evaluate whether the lender's response persuasively contradicts the existence of the significant disparity or establishes a business justification. Consult the supervisory office, compliance manager, district counsel, and/or compliance management department, as appropriate.

B. Discriminatory pre-application screening.

Obtain an explanation for any:

- Withdrawals by applicants in prohibited basis groups without documentation of customer intent to withdraw;
- Denials of applicants in prohibited basis groups without any documentation whether qualified; or
- On a prohibited basis, selectively quoting *strongly unfavorable* terms (for example, high fees or downpayment requirements) to prospective applicants, or quoting *strongly unfavorable* terms to all prospective applicants but waiving such terms for control group applicants. (Evidence of this might be found in withdrawn or incomplete files.)

If the lender cannot explain the situations, examiners should consider obtaining authorization to contact the customers to verify the lender's description of the transactions. Information from the customer may help determine whether a violation occurred.

In some instances, such as possible "prescreening" of applicants by lender personnel, the results of the procedures discussed so far, including interviews with customers, may be inconclusive in determining whether a violation has occurred. In those cases, examiners should, if authorized by their agency, consult with management regarding the possible use of "testers" who would pose as apparently similarly situated applicants, differing only as to race or other applicable prohibited basis characteristic, to determine and compare how the lender treats them in the application process.

C. Possible discriminatory marketing

1. Obtain full documentation of the nature and extent, together with management's explanation, of any:

- Prohibited basis limitations stated in advertisements;
- Code words in advertisements that convey prohibited limitations; or
- Advertising patterns or practices that a reasonable person would believe indicate prohibited basis customers are less desirable.

2. Obtain full documentation as to the nature and extent, together with management's explanation, for any situation in which the lender, despite the availability of other options in the market:

- Advertises only in media serving nonminority areas of the market;
- Markets through brokers or other agents that the lender knows, or could reasonably be expected to know, to serve only one racial or ethnic group in the market; or
- Utilizes mailing or other distribution lists or other marketing techniques for pre-screened or other offerings of residential loan products***** that:

  — Explicitly exclude groups of prospective borrowers on a prohibited basis; or

  — Exclude geographies (e.g., census tracts, ZIP codes, etc.) within the institution's marketing area that have demonstrably higher percentages of minority group residents than does the remainder of the marketing area, but which have income and other credit-related characteristics similar to the geographies that were targeted for marketing.

*** NOTE:** Pre-screened solicitation of potential applicants on a prohibited basis does not violate ECOA. Such solicitations are, however, covered by the FH Act. Consequently, analyses of this form of potential marketing discrimination should be limited to residential loan products subject to coverage under the FH Act.

3. Evaluate management's response particularly with regard to the credibility of any nondiscriminatory reasons offered as explanations for any of the foregoing practices. Refer to **Evaluating Responses to Evidence of Disparate Treatment** elsewhere in the **Appendix** for guidance.

Streamlining the Examination

Institutions may find it advantageous to conduct self-evaluations and, provided the examiners confirm the reliability and appropriateness of the self-evaluation (or even parts of it), they need not repeat those tasks. If the institution has performed a self-evaluation of any of the product(s) selected for examination, unless agency policy prohibits examiners from requesting the results, obtain a copy thereof and proceed through the remaining steps of this section on Streamlining the Examination. If the institution has conducted a self-evaluation of a product not selected in the scope of the examination, consider whether the product evaluated by the institution is appropriate under the scoping guidelines to substitute for another product that was selected. If such a substitution is considered appropriate, obtain the results of the self-evaluation for the substituted product and proceed through the remaining steps of this section.

Determine whether the research and analysis of the planned examination would duplicate the institution's own efforts. If the answers to Questions A and B below are both **Yes**, each successive **Yes** answer to Questions C through L indicates that the institution's work up to that point can serve as a basis for eliminating steps for the examiners.

If the answer to either Question A or B is **No**, the self-evaluation cannot serve as a basis for eliminating examination steps. However, you should still evaluate the self-evaluation to the degree possible in light of the remaining questions and communicate the findings to the lender so that it can improve its self-evaluation process.

A. Did the transactions covered by the self-evaluation occur not longer ago than two years prior to the examination? *If the self-evaluation covered more than two years prior to the examination. i*ncorporate only results from transactions in the most recent two years.

B. Did it cover the same product, prohibited basis, decision center, and stage of the lending process (for example, underwriting, setting of loan terms) as the planned examination?

C. Did the self-evaluation include comparative file review? **NOTE**: One type of "comparative file review" is statistical modeling to determine whether similar control group and prohibited basis group applicants were treated similarly. If a lender offers self-evaluation results based on a statistical model, consult appropriately within your agency.

D. Were control and prohibited basis groups defined accurately and consistently with ECOA and/or the FHAct?

E. Were the transactions selected for the self-evaluation chosen so as to focus on marginal applicants or, in the alternative, selected randomly?

F. Were the data abstracted from files accurate? Were those data actually relied on by the credit decision makers at the time of the decisions?

To answer these two questions and Question G below, for the institution's control group sample and each of its prohibited basis group samples, request to review 10% (but not more than 50 for each group) of the transactions covered by the self-evaluation. For example, if the institution's self-evaluation reviewed 250 white and 75 black transactions, plan to verify the data for 25 white and seven black transactions.

G. Did the 10% sample reviewed for Question F also show that customer assistance and lender judgment that assisted or enabled applicants to qualify were recorded systematically and accurately and were compared for differences on any prohibited bases?

H. Were prohibited basis group applicants' qualifications related to the underwriting factor in question compared to corresponding qualifications of control group approvals? Specifically, for self-evaluations of approve/deny decisions, were the denied applicants' qualifications related to the stated reason for denial compared to the corresponding qualifications for approved applicants?

I. Did the self-evaluation sample cover at least as many transactions at the initial stage of review as examiners would initially have reviewed using the sampling guidance in these procedures?

If the lender's samples are significantly smaller than those in the sampling guidance but its methodology otherwise is sound, review additional transactions until the numbers of reviewed control group and prohibited basis group transactions equal the minimums for the initial stage of review in the sampling guidance.

J. Did the self-evaluation identify instances in which prohibited basis group applicants were treated less favorably than control group applicants who were no better qualified?

K. Were explanations solicited for such instances from the persons responsible for the decisions?

L. Were the reasons cited by credit decision makers to justify or explain instances of apparent disparate treatment supported by legitimate, persuasive facts or reasoning?

If the questions above are answered **Yes**, incorporate the findings of the self-evaluation (whether supporting compliance or violations) into the examination findings. Indicate that those findings are based on verified data from the institution's self-evaluation. In addition, consult appropriately within the agency regarding whether or not to conduct corroborative file analyses in addition to those performed by the lender.

If not all of the questions in the section above are answered Yes, resume the examination procedures at the point where the lender's reliable work would not be duplicated by the examiners. In other words, use the reliable portion of the self-evaluation and correspondingly reduce independent comparative file review by examiners. For example, if the institution conducted a comparative file review that compared applicants' qualifications without taking account of the reasons they were denied, the examiners could use the qualification data abstracted by the institution (if accurate) but would have to construct independent comparisons structured around the reasons for denial.

Introduction

The Equal Credit Opportunity Act as implemented by Regulation B prohibits discrimination with respect to any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has capacity to contract), receipt of income from public assistance programs, and good faith exercise of any rights under the Consumer Credit Protection Act. According to §202.2(1), the regulation applies to all persons who, in the ordinary course of business, regularly participate in the decision regarding whether or not to extend credit or the amount that is to be extended.[1]

The regulation has been structured to cover the requirements imposed on a financial institution before, during, and following the application and evaluation process of granting credit. Both the Equal Credit Opportunity Act and Regulation B set out a basic rule for credit grantors in §202.4:

"A creditor shall not discriminate against any applicant on a prohibited basis with respect to any aspect of a credit transaction." Unlawful discrimination also occurs if an applicant is denied because of prohibited considerations concerning the applicant's business associates or persons who will be somehow related to the extension of credit (for example, the race of persons residing in the neighborhood where collateral is located).

To prevent discrimination, Regulation B imposes a delicate balance on the credit system, recognizing both the financial institution's need to know as much as possible about a prospective borrower and the borrower's right not to disclose information that is irrelevant to the transaction. The regulation deals with taking the application, evaluating the application, acting on the application, and furnishing and maintaining credit information. One should note that Regulation B does not prevent a creditor from determining any pertinent information necessary to evaluate the creditworthiness of an applicant.

1 The ninth judicial circuit, which includes the states of Arizona, California, Idaho, Montana, Nevada, Oregon, and Washington, has found that the ECOA is applicable to consumer lease (Brothers v. First Leasing (724 F2d 789 at 795-96, 9th Cir. (1984))).

Administration and Enforcement

The Act gives the Federal Reserve Board the responsibility for writing Regulation B. The Board is also responsible for administering the rules through amendments and the official staff commentary under section 706(e) of the ECOA.

General Enforcement

Administrative enforcement of the Act is distributed among twelve supervisory Federal agencies and the Department of Justice. For the most part, the Federal agencies with general supervisory authority over a particular group of creditors are given Equal Credit Opportunity enforcement responsibility over those creditors.

OTS Enforcement — Examiner Responsibility

The Office of Thrift Supervision is responsible for enforcement among insured institutions, and this responsibility is carried out by the regional offices largely through the examination program. The adequacy of each institution's compliance with Regulation B is normally determined during regularly-scheduled compliance examinations. Violations are noted and agreements with management for prompt correction of violations are obtained.

Taking the Application

Prescreening and Advertising — §202.5(a)

Regulation B's concern with the application process starts before the application is even taken. Lending officers and employees must be careful to take no action that would, on a prohibited basis, discourage anyone from applying for a loan. A financial institution may not, therefore, advertise in ways that would tend to encourage some types of borrowers and discourage others, on a prohibited basis. The portion of this handbook covering the Fair Housing Act contains a discussion of this issue.

Coming closer to the application process itself, prescreening tactics that tend to discourage potential applicants are also prohibited. For instance, instructions to loan brokers to use scripts or other means to discourage minority applicants from applying for credit would constitute a violation.

The prohibition against discouraging applicants applies to oral or telephone inquiries and applications, as well as to the written variety. Therefore, in the pre-interview, and when taking a written application, lending officers must refrain from asking for prohibited information. Questions must be neutral in nature, of a type applicable to and asked of every applicant desiring the same kind and amount of credit.

Providing Appraisal Reports — §202.5a

The regulation provides credit applicants with a right to receive copies of appraisal reports. This section applies to applications for credit to be secured by a consumer's dwelling, whether it is extended for a business purpose (for example, to start a business) or a consumer purpose (for example, a loan to finance a child's education).

There are two ways a financial institution can provide the appraisal report:

(1) by routinely providing a copy to an applicant, whether credit is granted or denied or the application is withdrawn, (2) upon an applicant's written request. If the financial institution only provides an appraisal report upon written request, then the applicant must be notified in writing of the right to receive a copy of the report. If there is more than one applicant, notice can be given to one applicant only, but it must be given to the primary applicant. The notice can be given at any time during the application process but not later than when the financial institution provides notice of action taken under section 202.9. The notice should specify that the applicant's request must be in writing, give the financial institution's mailing address, and state the time for making the request.

Section 202.5a(a) applies if an applicant requests a renewal of an existing extension of credit and the financial institution obtains a new appraisal report to evaluate the request, but it does not apply to a renewal request if the previous appraisal report is used to determine whether to grant credit.

A financial institution is required to mail or deliver a copy of the appraisal report promptly, generally within 30 days, after acquiring the appraisal report, receiving a request from the applicant, or receiving reimbursement from the applicant for the report, whichever is the last to occur. Financial institutions do not have to provide a copy of the appraisal report when the applicant's request is more than 90 days after the financial institution provided notice of action taken on the application under section 202.9 or 90 days after the application is withdrawn.

A financial institution may be reimbursed for photocopy and postage costs incurred in providing the appraisal report, unless prohibited by state or other law. If the applicant has already paid for the appraisal report, as part of the application fee, the financial institution may not seek additional fees, other than photocopy and postage stamps. Also, if the financial institution does not otherwise charge for the appraisal report, it may not require a payment solely from applicants who request a copy of the report.

The Regulation B Commentary defines dwelling” and “appraisal report.”

Request For Information Concerning a Spouse or Former Spouse — §202.5(c)

Regulation B requires that certain conditions be met before lenders can seek information about an applicant's spouse. As a general rule, the financial institution may not request information about an applicant's spouse. However, the financial institution may request information about the spouse or former spouse in any of the following cases:

- The nonapplicant spouse will be a user of or joint obligor on the account. (*Note:* the term “user” applies only to open-end accounts.)

- The nonapplicant spouse will be contractually liable on the account.
- The applicant is relying on the spouse's income, at least in part, as a source of repayment.
- The applicant is relying on alimony, child support, or separate maintenance income as a basis for obtaining credit.
- The applicant resides in a community property state or property upon which the applicant is relying as a basis for repayment of the credit requested is located in such state.

Section 202.5(c)(3) allows a financial institution to request a list of all accounts upon which the applicant is liable, the name and address in which the accounts are carried, and any other names used previously to obtain credit.

Unless the need is apparent from an affirmative indication regarding one of the above criteria, no financial institution may request information on an applicant's spouse.

Inquiries Concerning Marital Status — §§202.5(d)(l) and (3))

Individual credit. When an applicant applies for individual credit, the financial institution may not ask the applicant's marital status. There are two exceptions to this rule:

1. If the credit transaction is to be secured, the financial institution may ask the applicant's marital status. (This information may be necessary to determine what would be required to gain access to the collateral in the event of default.)

2. If the applicant either lists assets to support the debt that are located in a community property state or resides in such a state, the financial institution may ask the applicant's marital status. (In community property states assets owned by a married individual may also be owned by the spouse, thus complicating the accessibility of the collateral in the event of default.)

Joint credit. Whenever a request for credit is joint (made by two or more individuals who will be primarily liable) the financial institution may always ask the applicant's marital status regardless of whether the credit is to be secured or unsecured.

Terminology. In instances in which the financial institution is permitted to inquire about marital status, only the terms “married,” “unmarried,” and “separated” may be used. This applies to oral as well as written requests for marital status information. “Unmarried” may be defined to include divorced, widowed, or never married, but the application must not be structured in such a way as to encourage the applicant to distinguish among these.

The financial institution may always ask questions concerning the applicant's income or assets that support the credit request. However, any such question must not be structured so as to encourage the applicant to indicate marital status. The financial institution may also ask questions to obtain relevant information that indirectly discloses marital status. For example, the financial institution, when asking about the customer's current payment obligations, may always inquire whether the applicant is obligated to pay alimony, child support, or separate maintenance payments. In addition, questions may be asked concerning the source of income or ownership of assets supporting the debt, and whether the debt obligations of the applicant have a co-obligor.

On the written application all terms must be neutral as to sex. “Husband” and “wife” and any other terms indicating sex must not be used. Courtesy titles indicating sex such as Mr., Mrs., Ms., and Miss may be used, but only if accompanied by a conspicuous statement that the designation of any such title is optional.

Alimony, Child Support, or Separate Maintenance Income — §202.5(d)(2)

A financial institution may ask if the applicant is receiving alimony, child support, or separate maintenance payments only if the financial institution first discloses to the applicant that such income does not need to be revealed unless the applicant wishes to rely on that source of income for determining creditworthiness. An appropriate notice to the effect that such income does not have to be revealed unless the applicant chooses to rely on it must be given whenever the financial institution makes any general request concerning income and the source of that income. Therefore, a financial institution must either ask questions designed to solicit only information about specific income (for example, salary, wages, employment income) or must state that disclosure of alimony, child support, or separate maintenance payments is not required.

Other Prohibited Inquiries

Under no circumstance may a financial institution request or use information about an applicant's birth control practices or child bearing intentions or capability. However, as a general rule, a creditor may request and consider any information regarding the applicant's continued ability to repay, such as the probability of continuing employment, so long as this inquiry is made of all applicants who are similarly qualified. The number, ages, and expenses of present dependents may also be requested. Making the assumption, however, that childbearing, or the potential for it, is always associated with a discontinuity in ability to repay is prohibited in an evaluation of creditworthiness by §202.5(d)(4).

The financial institution may inquire about the applicant's permanent residence and immigration status in order to determine creditworthiness as defined in §202.5(d)(5). However, the financial institution may not arbitrarily deny credit to some aliens and not others, merely on the grounds that the ones denied are not citizens. (Although the practice of denying credit to all noncitizens may not be prohibited under Regulation B, it is probably illegal under other Federal laws, particularly the Civil Rights Act of 1870. 42 U.S.C. §1981.)

Written Application — §202.5(e)

The regulation requires that a financial institution must take an application in writing for some dwelling related loans. These are loans to purchase or refinance a dwelling. A financial institution is required to write down the information they normally consider when making those loans. It is also required to ask the applicants their race or national origin, sex, marital status and age. This information is used by enforcement agencies to make certain that the financial institution is not discriminating on a prohibited basis in making these loans. Written applications are not required for other types of credit. However, OTS regulations require institutions to inform inquirers of the right to file a written loan application (§528.3(b)) for any type of credit request.

Evaluating the Application

General Rule Governing the Use of Information — §202.6(a)

In evaluating the application, the financial institution may not consider any information it obtains to discriminate on a basis prohibited under Regulation B.

Prohibited Considerations — §202.6(b)(1)

1. A financial institution may not use marital status as a basis for determining the applicant's creditworthiness. However, an institution may consider marital status for the purpose of ascertaining whether state law gives the applicant's spouse an interest in the property being offered as collateral.

Prohibited Considerations — §202.6(b)(2) - (7)

1. A financial institution may not consider the applicant's age (provided the applicant is old enough, under State law, to have the capacity to contract) unless it is used for the purpose of determining a pertinent element of creditworthiness or in an appropriate credit scoring system. The age of an elderly applicant (62 years or older) may always be considered when used in the applicant's favor.

    a. In a judgmental credit evaluation system, age is considered legitimately pertinent when considered in connection with occupation, to determine the amount of employment or retirement income which will support the debt until maturity; to determine whether the security is adequate to cover the debt if the maturity of the extension exceeds the life expectancy of the applicant; or to assess the significance of the applicant's length of employment or residence.

b. In an empirically derived demonstrably and statistically sound, credit scoring system, a financial institution may use an applicant's age as a predictive factor, provided that the age of an elderly applicant is not assigned a negative factor or value.

2. A financial institution may not consider whether the applicant receives income from a public assistance program. A creditor cannot deny credit, or grant credit on more onerous terms, because some or all of the applicant's income is derived from public assistance. However, a creditor may consider probable continuity of such income. Unemployment compensation, social security, and aid to families with dependent children are examples of the types of programs covered by the prohibition.

3. A financial institution may neither refuse to consider nor discount the income of an applicant or spouse on a prohibited basis or because it is part time. The income of a spouse used in an application for credit must be considered equally with that of the applicant. In addition, income derived from annuity, pension, or retirement benefits must not be discounted. The financial institution may, however, consider the amount and probable continuity of any income in evaluating the application. A financial institution must consider alimony, child support, or separate maintenance income voluntarily listed by the applicant in support of the debt to the extent that payments will be likely to continue. Methods for determining the likelihood of the continuity of payments may include, but are not limited to, the following:

   a. whether the payments are provided for by oral or written agreement, or by court decree;

   b. the length of time payments have been made;

   c. whether the receipt of payments has been recent and regular;

   d. the ability to compel payment; and

   e. the creditworthiness and credit history of the payor, where available to the financial institution in accordance with the Fair Credit Reporting Act or other law.

4. Regulation B forbids asking about an applicant's plans or expectations to have children or an applicant's physical capability for childbearing. Furthermore, a creditor is prohibited from considering statistics or making assumptions concerning the probability that a person like the applicant or the applicant's spouse will have a certain number of children, or will cease employment to bear or raise children.

5. To the extent a financial institution uses credit history in evaluating applications, it must consider in evaluating creditworthiness any account reported in the name of both spouses, and, on the applicant's request, any account reported in the name of the applicant's spouse which the applicant can demonstrate reflects the applicant's willingness or ability to repay. If the applicant requests, the financial institution must also consider any information that the applicant may present tending to indicate that the credit history of an account reported in both names does not accurately reflect the applicant's ability or willingness to repay. To facilitate this inquiry, Regulation B allows a financial institution to request the name in which an account is carried if the applicant discloses the account in applying for credit.

6. The financial institution may consider whether an applicant is a permanent resident of the United States and the applicant's U.S. immigration status to the extent that this information is necessary to ascertain the financial institution's rights and remedies with respect to repayment.

Credit Scoring System

Regulation B neither requires nor endorses any particular method of credit analysis. Creditors may use traditional methods that rely on a credit officer’s subjective evaluation of an applicant's creditworthiness, or they may use more objective' statistically developed techniques such as credit scoring. For purposes of certain regulatory provisions, however, Regulation B divides the field of creditor analysis in two categories:

1. Credit scoring systems that qualify as “empirically derived, demonstrably and statistically sound”; and

2. Judgmental systems.

All forms of credit analysis fall into one category or the other. The regulation (§202.2(p)) prescribes the standards that a credit scoring system must meet in order to qualify as a “empirically derived, demonstrably and statistically sound, credit system.” All forms of credit analysis that do not meet these standards are automatically classified as “judgmental” systems. The division of credit analysis systems into these two categories is important because creditors that use a “demonstrably and statistically sound” system may take the age of an applicant directly into account as a predictive variable. Judgmental systems may not do this.

The ECOA's prohibition against age discrimination specifically provides that it does not constitute discrimination for a financial institution:

“To use any empirically derived credit system which considers age if such system is demonstrably and statistically sound in accordance with regulations of the Board, except that in the operation of such system the age of an elderly applicant may not be assigned a negative factor or value . . . .”

Several conditions are built into this statutory provision:

- The credit system should be empirically derived (that is, based on credit experience).

- The system should be “demonstrably and statistically sound” in accordance with regulations prescribed by the Federal Reserve Board.

- The age of an elderly applicant should not be assigned a negative factor or value.

Regulation B implements this provision by first de empirically derived credit systems” in general terms-that is, as systems that evaluate creditworthiness by assigning points to various attributes of the applicant (and, perhaps also, to attributes of the credit requested). The points assigned are derived from a statistical analysis of recent creditworthy and noncreditworthy applicants of the financial institution.

The second part of the definition prescribes the standards that an empirically derived credit system must meet in order to qualify as a “empirically derived, demonstrably and statistically sound, credit system.”

These standards include the following requirements:

- The data used to develop the system derive either from an empirical comparison of sample groups or the population of creditworthy and noncreditworthy applicants who applied for credit within a reasonable period of time.

- That the system be developed for the purpose of evaluating the creditworthiness of applicants with respect to the legitimate business interests of the creditor utilizing the system.

- That the system must be developed and validated using statistical principles and methodology.

- That the creditor periodically reevaluate the predictive ability of the system by the use of statistical principles and methodology and adjusts it as necessary.

Credit scoring systems that meet these criteria may take the applicant's age directly into account and assign points to age (subject to the limitation on assigning a negative factor or value to the age of an elderly person).

Judgmental Systems

As noted above, any system other than an empirically derived, demonstrably and statistically sound, credit system is a judgmental system (including any credit scoring system that does not meet the prescribed technical standards). Such a system cannot take the applicant's age directly into account in evaluating creditworthiness. The act and the regulation do, however, permit a creditor to consider the applicant's age for the purpose of evaluating other information about the applicant that had a demonstrable relationship to creditworthiness.

- A creditor may consider, for example, the occupation and length of time to retirement of an applicant to ascertain whether the applicant's income will support the extension of credit until its maturity;
- The financial institution may consider the adequacy of any security offered if the duration of the credit extension will exceed the life expectancy of the applicant. An elderly applicant might not qualify for a 30-year mortgage loan because the duration of the loan exceeds the applicant's life expectancy and the cost of realizing on the collateral might exceed the applicant's equity. The same applicant might qualify with a larger downpayment and a shorter loan maturity;
- A creditor could also consider an applicant's age, for example, to assess the significance of the applicant's length of employment or residence (a young applicant may have just entered the job market; an elderly applicant may recently have retired and moved from a long-time residence).

In none of these examples, however, is age being directly considered in a decision to evaluate creditworthiness. A system, for instance, that only permits an applicant over the age of 70 to have a repayment term of one year whereas a younger applicant is permitted to repay the credit over a three year period is not lawful.

Extending or Denying Credit

Separate Account — §202.7(a)

No financial institution may refuse, on the grounds of sex, marital status, or any other prohibited basis, to grant a separate account to a creditworthy applicant. If a creditor offers separate accounts to unmarried applicants, it must offer separate accounts to creditworthy married applicants, and vice versa regardless of sex. Laws preventing the separate extensions of consumer credit to each spouse are preempted if the spouse voluntarily applies for separate credit. If the spouses apply for separate extensions of credit, the accounts must be aggregated to determine finance charges or loan ceilings under state law or laws of the United States.

Name on the Account — §202.7(b)

No financial institution may refuse to allow an applicant to open or maintain an account in a birth-given first name and surname, the spouse's surname or birth-given first name, or a combined surname. However, the financial institution may require that the applicant use one name consistently in doing business with the financial institution. In addition, the financial institution may inquire whether the applicant has obtained credit in another name or is liable for accounts listed in another name in order to determine the entire credit history of the applicant.

Change in Name or Marital Status — §202.7(c)

A financial institution may not take the following actions, with respect to any person who is contractually liable on an existing open end account on the basis of age, retirement or a change in the applicant's marital status.

- Require a reapplication (except in limited circumstances).
- Change the terms of the account.
- Terminate the account.

If the financial institution does learn of a change in the marital status of any contractually liable person on an existing account, it may require a reapplication under the following conditions:

- If the account was granted to a person who is contractually liable and the decision was to grant the credit based in part on the income of that person's spouse, and if the income of that person, by themself, does not now support the current line of credit the financial institution may require a reapplication. The financial institution, however, may not deprive the person of the use of the credit line while the reapplication is being evaluated. The financial institution may evaluate the application based on its current credit standards. It must meet the regular requirements of Regulation B for evaluating and notifying the applicant of the action taken by the financial institution.

Signature Requirement — §202.7(d)

Among the key sections of Regulation B as it relates to sex and marital status discrimination are the ones regarding the signatures a financial institution may require when granting a loan. The purpose of these sections is to permit people (and particularly women) who are creditworthy in their own right to obtain credit on their own by removing, to the greatest possible extent, any dependence on a spouse *(including guarantors, sureties, endorsers, and other similar parties).*

There are two general rules which apply throughout the sections on signature requirements:

First, a financial institution may not require a signature other than the applicant's or joint applicant's, if under the financial institution's standards of creditworthiness the applicant qualifies for the amount and terms of the credit requested.

Second, a financial institution has much more latitude in seeking signatures for instruments necessary to reach property used as security, or in support of the customer's creditworthiness than it does obtaining signatures by persons other than the applicant on documents that establish the contractual obligation to repay.

To understand the second general principle it is necessary to keep in mind that there is an important distinction between debt instruments, such as the note itself, and instruments, such as a mortgage, Deed of Trust, or other security device, which are necessary to secure the credit and to reach and obtain property in the event of default. The former type of instrument-the note-is a legal admission that a debt exists. A person who signs a note accepts a personal obligation to repay the debt in full-even though there may be other signatories or someone else may have received the actual proceeds of the loan. A mortgage, or security agreement, on the other hand, creates a far more limited obligation-one which only allows the financial institution to reach the signer's interest in the property described, in the event of default. If, after default and the sale of the pledged property, an amount remains due to the financial institution, someone who has signed only a mortgage or other security agreement is not obligated to pay that amount.

Joint applicants. A financial institution may obtain the signature of all joint applicants, on both the note and the security instrument. It is irrelevant whether the applicants are married so long as the application is intended by the applicants to be joint, that is with the assets of both borrowers supporting the debt and with joint liability. The only difficult aspect of this rule is in determining who are joint applicants. If two people come in to the financial institution and voluntarily make joint application there is no problem, of course, and the financial institution need not try to discourage this. However, if two people come in together but only one applies, the financial institution may not attempt to persuade the other to join, or require a joint application, if the individual applicant is creditworthy. If there is any doubt as to the applicants' intent, the loan officer should ask for clarification.

Cosigners¾§202.7(d)(5). If it is determined that an applicant for individual credit cannot support the credit in that person's own right, according to the financial institution's objective, nondiscriminatory standards, it may then request that the applicant obtain a cosigner, guarantor, or the like. In all such cases, however:

- The financial institution must require a cosigner or guarantor in all circumstances where the applicants are similarly situated. In other words, it cannot require cosigners only for unmarried applicants, or only for married applicants, or only for women, or men, or blacks.
- The financial institution may not require that the applicant's spouse be the cosigner, although the applicant may so choose.
- The financial institution may not impose requirements on the cosigner or guarantor that it is prohibited from imposing on the applicant.

Signature of the Applicant's Spouse¾§202.7(d). In certain circumstances a financial institution may request the spouse's signature, even where a married applicant applies for individual credit:

1. *Secured credit*—§202.7(d)(4). When the loan is to be made on the basis of a security interest taken by the financial institution in a particular piece of property, a financial institution may require any person, including the applicant's spouse, who owns an interest in the property to sign any instrument which the financial institution reasonably believes to be necessary under state law to make the property being offered as security available to satisfy the debt in the event of default. In a noncommunity property state, this will normally not include the note itself.

2. *Unsecured credit*—§202.7(d)(2). When the applicant requests unsecured credit but relies in part on property of some kind to establish creditworthiness, if the property relied on is necessary to satisfy the financial institution's objective, nondiscriminatory standards of credit risk, the financial institution may require the signature of the co-owner or any other person with an interest in the property on any instrument necessary, or reasonably believed to be necessary, under State law to make the property relied on available to satisfy the debt in the event of death or default of the applicant.

   In deciding what is reasonably necessary, a financial institution may look not only at state law, but also the form of ownership of the property, its susceptibility to attachment, execution, severance, and partition, and any other factors that may affect the value of the applicant's interest in the property to the creditor. But the fact that the spouse may use property being relied on (such as a car) does not necessarily mean that each person's signature is "necessary" for the financial institution's legal protection. Some stronger ownership interest than mere use is generally required. Also, if one spouse has authority under State law to commit enough of the jointly held property to establish creditworthiness without the other spouse's signature' such a signature is not "necessary" to reach the property and the financial institution may not require it.

3. *Community property states.* Consistent with the general principles addressed previously, a separate set of rules applies if a married applicant requests individual unsecured credit and resides in a community property state, or if the property upon which the applicant is relying is located in a community property state. In such circumstances, a financial institution may require the signature of the spouse on any instrument including the note necessary under the law of the state in which the applicant resides, or in which the property is located, to make the community property available to satisfy the debt in the event of default, only if:

   a. The applicable state law denies the applicant power to manage or control enough community property to qualify for the credit requested; and

   b. The applicant does not have sufficient separate property to qualify, without regard to the community property.

Of course, even in a community property state a financial institution may always require the spouse's signature on any instrument necessary to reach the collateral for a secured loan, but a financial institution may not automatically require a spouse's signature on the note, except in conformance with the above rules. The legal department in a District Bank can provide information on which states are considered community property states.

Integrated instruments. A financial institution may not require the spouse to sign an "integrated instrument" that combines the note, security agreement, and other disclosures, where the non-applicant spouse's signature would not be required on the note under the rules stated above. Where a spouse's signature is necessary to reach the property relied on, and the financial institution habitually uses an integrated form, the financial institution should have the spouse sign a separate security agreement.

Establishment of a credit history. A financial institution may permit a nonapplicant spouse to sign a note, and thereby become obligated to repay the loan, if the spouse volunteers to do so. Some spouses may wish to use this option to help create a credit history which would operate in their own favor.

Business credit. The business exemptions of Regulation B (§202.3(d)(2)) *do not* apply to the signature requirements. Accordingly, a spouse's signature may be required in a business setting only in the same circumstances that it could in other loans.

Insurance

When the financial institution offers casualty, credit life, health, accident, disability or other credit insurance, differences in cost, terms, or availability of the insurance will not constitute violations of the regulation. However, the financial institution may not deny or terminate credit merely because the insurance is unavailable on account of the applicant's age. When insurance is desired by the applicant, information regarding the applicant's age, sex, or marital status may be requested for the purpose of offering insurance.

As noted in the discussion of insurance in the FHA portion of this handbook, the treatment of insurance under the FHA rules may not be the same when dealing with housing credit.

Notification — §202.9

Notification of action taken. The financial institution is required to give notice of both favorable and adverse action. Notice of approval can be implied, such as by providing the requested credit card.

The financial institution must notify the applicant of action taken within 30 days after receipt of a completed written or oral application. (A completed application is one for which a creditor has received all the information it regularly obtains and considers in evaluating applications.) There are two exceptions: (1) the financial institution must notify an applicant to whom it has made a counteroffer, of the adverse action, within 90 days unless the applicant accepts or uses the credit during that time; and (2) when the financial institution and the applicant agree that the applicant will inquire about what action was taken and the applicant fails to do so within 30 days of application the financial institution need not provide the required notification of approval.

The financial institution must notify an applicant of adverse action taken on an incomplete application or with respect to an existing account within 30 days.

Adverse action — §202.2(c)

Adverse action means:

- A refusal to grant credit in substantially the amount or terms requested unless the creditor makes a counteroffer and the alternative offer is accepted by the applicant;
- A termination of an existing account or a change in terms on an existing account which is undesirable if the same action is not taken on a substantial portion of similar accounts;
- A termination of an account due to past delinquency or default, when such delinquency or default was cured prior to the creditor's action; or
- A denial of an increase in the credit available to the applicant when requested in accordance with appropriate financial institution procedures.

Adverse action does not include:

- Any change in the terms of an account which is expressly agreed to by the applicant;
- Any action or forbearance taken in connection with inactivity, current delinquency, or current default on an account;
- A denial of credit at the point of sale or loan (for example, when a customer unsuccessfully attempts to use a credit card) unless (a) the denial is a termination or unfavorable change in terms that does not affect all or a substantial portion of a classification of the creditor's accounts, or (b) the denial is a reapplication to

increase the amount of credit available for the account;

- A denial of credit because extending the credit requested is prohibited by laws affecting the financial institution; or
- A denial of credit because the financial institution does not offer the type of credit requested.

Contents of Adverse Action Notice¾ §202.9(a)(2). Whenever adverse action is taken, the financial institution must supply the applicant with the following, in writing:

- The ECOA notice as described in the regulation; and
- A statement of specific reasons for the action taken, or a disclosure of the applicant's right to request such a statement and to receive it within 30 days after the financial institution receives the request. The applicant must make the request within 60 days of the notice of action taken.

The financial institution's disclosure of the right to receive a statement of the reasons for denial must include the name, address, and telephone number of the individual or office where the reasons may be obtained. When the financial institution chooses to disclose the reasons for denial orally, the applicant must also be informed of the right to receive written confirmation of the reasons within 30 days from written request.

If the financial institution chooses to disclose the specific reasons for adverse action, the financial institution has two options:

1. The financial institution may formulate its own checklist or letter which provides the specific principal reasons for adverse action, or
2. The financial institution may use the sample forms in Appendix C of Regulation B.

Incomplete Application¾§202.9(c)(1). When an incomplete application is received, the financial institution shall notify the applicant within 30 days either:

1. Of action taken using procedures in §202.9 (a); or
2. Request the additional information needed from the applicant.

If additional information is needed and if the applicant fails to respond, within a reasonable period of time, the financial institution has no further obligation. If the applicant supplies the requested information within the requested time period, the financial institution shall take action on the application and notify the applicant.

Multiple applicants. If two or more persons make a joint application, the notification has to only be given to one of the primarily liable applicants.

Multiple creditors. When more than one creditor is involved in the transaction, and the credit is denied or a counteroffer is not accepted by the applicant, each creditor who takes such adverse action must make the required notification. This notification may be provided by a creditor or indirectly through a third party (for example by agreement, through a retailer who offers the credit transaction to the financial institution for discounting) if the identity of all creditors taking the action is given.

A financial institution is not liable for a failure to comply with the notification requirements if the failure was caused by an "inadvertent error," as defined, *and*, after discovering the error, (1) the financial institution corrects the error as soon as possible, and (2) begins to comply with the regulation.

Other Rules

Furnishing Credit Information — §202.10

One of the primary methods used by financial institutions to determine creditworthiness is to examine the customer's credit history compiled and maintained by credit reporting agencies. Prior to the enactment of ECOA many women found it difficult to obtain credit because of the way in which these credit histories were developed, maintained, and operated by the credit reporting agencies. Frequently, accounts were reported only in the husband's name, even when the wife was jointly liable or was the person primarily responsible for seeing to it that the debt was properly repaid.

Additionally, women were sometimes denied credit because of their husbands' bad credit histories for which the wives were not responsible. The result was that women did not benefit from the good credit histories they participated in developing and were penalized for bad ones that were not of their doing.

Regulation B takes steps to rectify this situation. Since the credit histories in credit reporting agencies are developed primarily from information supplied by creditors themselves, the regulation sets forth requirements aimed at the method by which creditors must maintain and report the information. These requirements are designed to enable customers, primarily women, to (1) develop their own credit histories; (2) have their joint accounts reflected in such a way that either joint or individual retrieval of information is possible; and (3) be assured that only the information pertinent to their own credit histories is reported and considered when they individually apply for credit.

It should be emphasized that financial institutions are not required to report credit information. The regulation only requires that if they do, they report it in accordance with the regulation's requirements.

Designation of accounts ¾ §202.10(a), (b), (c). A creditor that furnishes credit information shall designate:

1. Any new account to reflect participation of both spouses if the applicant's spouse is permitted to use or is contractually liable on the account;

2. Any existing account to reflect participation within 90 days after receiving a written request to do so from one of the spouses.

If a creditor furnishes credit information to a consumer reporting agency, the creditor shall furnish the information in the name of the spouse about whom the information was requested.

Accounts held or used by spouses as de fined in the official commentary to Regulation B apply only to creditors that furnish credit information to credit bureaus or to other creditors. A financial institution that furnishes credit information has the option to designate on all joint accounts the participation of both parties, whether or not the accounts are held by persons married to each other. A financial institution need not distinguish between accounts on which the spouse is an authorized user and a contractually liable party. A financial institution is not required to create or maintain separate files in the name of each participant on a joint account, but it must be able to report information in the name of each spouse on the account.

Inadvertent errors within the meaning of the regulation, resulting in failure to comply with requirements regarding furnishing credit information will not be considered violations of the regulation if the financial institution takes corrective action and begins complying immediately upon discovering the error. (See §202.14)

Retention of Records — §202.12

Retention of Prohibited Information ¾ §202.12(a). A creditor may retain in its files under certain circumstances, information that is generally prohibited, if the information was obtained:

1. From any source prior to March 23, 1977;

2. From consumer reporting agencies, an applicant, or others without the specific request of the creditor;

3. As required to monitor compliance with the act and this regulation or other federal or state statutes or regulations.

While the financial institution may retain such information in its files, care must be taken to ensure that it will not be considered in evaluating creditworthiness.

Applications ¾ §202.12(b)(1). The financial institution must retain the original or a legible copy of the following information for 25 months after the date the financial institution informs the applicant of notice of action taken on the application or incompleted application:

- Any application, any information required to monitor compliance with the Act, and all written or recorded information used in evaluating the application which has not been returned pursuant to the applicant's request.
- Copies of written documents and any recorded notation or memorandum of oral communication of the notification of action taken on the application, the statement of specific reasons for adverse action, and any written statement from the applicant alleging a violation of the regulation or the Act.

Existing Accounts. The financial institution must also retain the original or copy of the following information for 25 months after the financial institution informs the applicant of adverse action regarding existing accounts:

- Any written or recorded information concerning such adverse action;
- Any written statement from the applicant alleging a violation of the regulation or the Act.

Incomplete Applications. The financial institution shall retain all written or recorded information concerning the applicant, including any notation of action taken, for 25 months after the date that the financial institution receives any application for which the financial institution is not required to comply with the notification requirements of §202.9. The 25-month requirement runs from the date of application when the application is withdrawn by the applicant or when the application is submitted to more than one creditor on behalf of the applicant, and the application is approved by one of the other creditors.

Self-tests---§202.12(b)(6). The financial institution must retain all written or recorded information about the self-test for 25 months after the self-test has been completed.

If the financial institution has received notice that it is under investigation for violation of the regulation, the financial institution must retain all the above information relating to the account or application under investigation until there has been a final disposition of the matter.

Special Purpose Credit Programs — §202.8

The following types of credit programs meet the definition of special purpose credit programs:

- Any credit assistance program authorized by federal or state law for the benefit of economically disadvantaged class of persons as defined in §202.8(a);
- Any credit assistance program offered by a nonprofit organization for the benefit of its members or for the benefit of an economically disadvantaged class of persons;
- Any special purpose credit program offered to meet special social needs by a profit making organization. Such a program must meet the following requirements:

  (1) A written plan must be developed which designates those classes of applicants who are eligible and the procedures and standards for the extension of credit.

  (2) The program will extend credit to those applicants who probably would not be able to obtain such credit on substantially similar terms as other applicants.

Any denial of credit to an applicant who did not qualify under a special purpose credit program is not a violation of the regulation.

If applicants in special purpose credit programs are required to have one or more common characteristics, such as race, color, religion, national origin, sex, marital status, age, or receipt of income from a public assistance program, the financial institution may request and consider these characteristics in determining the eligibility of applicants for such a program without violating the regulation. If financial need is to be used as determining factor under a special purpose credit program, information concerning the applicant's marital status, income from alimony, child support, or separate maintenance payments, or financial information on the spouse may be requested and considered to determine the applicant's eligibility for such a program. In addition, the signature of a spouse or other person on the application or credit instrument may be obtained, if required for eligibility under federal or state law. Considering this information and requiring a signature will not be a violation of the regulation if used to determine eligibility for the program.

Information for Monitoring Purposes — §202.13 (see also Section 200: Fair Lending — General)

In order to monitor compliance with the regulation, financial institutions must request and maintain the following information regarding written applications for the purchase or the refinancing of a dwelling occupied or to be occupied, by the applicant as a principal residence, where the extension of credit will be secured by the dwelling (dwelling means a residential structure that contains 1-4 family units, individual condominium or cooperative unit, and a mobile or other manufactured home). Bank Board regulations require that monitoring information be collected on all home improvement loans, as well as construction loans and investments by persons in one-to-four unit dwellings (§528.6(d)(1)). An application for an extension of credit secured by a dwelling shall request the following information regarding any applicants:

- Race/national origin, using the categories American Indian or Alaskan Native; Asian or Pacific Islander; Black; White; Hispanic; Other (Specify):
- Sex;
- Marital status, using the categories "married," "unmarried," and "separated"; and
- Age.

The information may be requested on the application form or on a separate sheet of paper that refers to the application. The applicant and joint applicant must be informed that the disclosure of such information is optional and that the information is requested by the Federal government for monitoring compliance with Federal laws that prohibit discrimination. If the applicant chooses not to supply the requested information, the creditor is required to note on the form the race or national origin and sex of the applicants on the basis of visual observation or surname. Some forms may not ask marital status and age if the information was requested as part of the application process (see model residential application form in Appendix B of the regulation). A financial institution that fails to request monitoring information or discourages applicants from supplying it is violating the regulation. Consequently, low response rates should be examined closely to determine the cause.

Relation to State Law — §202.11

Regulation B alters, affects, or preempts only those State laws that are inconsistent with the Act or Regulation B, and then only to the extent of the inconsistency. A determination as to whether a state law is inconsistent will be made if a formal Board interpretation is requested.

Any person may apply for such an interpretation. The regulation does not alter any provision of State property laws or Federal or State banking regulations which deal with the solvency of such institutions, or laws relating to the disposition of a decedent's property.

Enforcement, Penalties and Liabilities —§202.14

In addition to actual damages, Regulation B provides for punitive damages of up to $10,000 in individual lawsuits and up to the lesser of $500,000 or one percent of the financial institution's net worth in class action suits. Successful complainants are also entitled to an award of court costs and attorney's fees.

"Inadvertent errors" is defined by §202.2(s) as errors of a mechanical, electronic, or clerical nature that the financial institution can show that (1) were not intentional and (2) occurred despite the fact that the financial institution maintains procedures reasonably adapted to avoid such errors. A financial institution is not liable for a failure to comply with the notification requirements of §202.9 if the failure was caused by an inadvertent error and after discovering the error, the financial institution (1) corrects the error as soon as possible and (2) begins compliance with the requirements of the regulation. Similarly a financial institution's failure to comply with §§202.6(b)(6), 202.10, 202.12 and 202.13 will not be considered a violation if it results from an inadvertent error and the financial institution takes the corrective action noted above. Errors involving §202.12 and §202.13 may be corrected prospectively by the financial institution.

Self-testing and Self-correction — §202.15

A financial institution may conduct a voluntary self-test to determine the level of its compliance with the ECOA. The self-test can be in the form of a program, practice or study to collect such information. The results of the self-test are privileged and are solely for the use of the financial institution.

This privilege applies to the data created and any analysis, opinions and conclusions pertaining to the self-test results. It covers workpapers or draft documents as well as final documents. It does not apply to whether a self-test was conducted, the methodology used or the scope of the self-test or the dates it was conducted. Also, it does not apply to the loan and application files in which the study derived its conclusions.

For the privilege of self-testing to apply, appropriate corrective action is required when the self-test shows that it is more likely than not a violation occurred, even though no violation has been formally determined.

Specialized Credit

Dealer Paper

When a financial institution purchases indirect paper from a dealer in the regular course of business, it is the responsibility of the financial institution to maintain procedures to determine whether the dealer is complying with the ECOA in all aspects of the credit transaction.

If the applicant within 30 days accepts a credit offer from the financial institution, no other notification is required from either the financial institution or the dealer. If credit is not extended by the financial institution or the applicant does not accept the financial institution's offer of alternate terms, each creditor taking adverse action must make notification to the applicant. For example, if a dealer attempts to obtain financing at several financial institutions and none of the financial institutions agree to extend credit or the applicant does not accept any alternative terms offered, all the financial institutions and any dealer acting as a creditor involved in the transaction must give the notices required for adverse action. Financial institutions may enter into contractual arrangements with dealers to provide all appropriate notices. When the dealer provides a joint notification, the financial institution will not be liable for actions or omissions resulting in violations, if the financial institution provided the dealer with the information necessary to comply with the notification requirements and the financial institution was maintaining procedures to avoid any such violation. Any joint notification must identify each creditor.

All creditors involved in an indirect credit transaction must retain all written or recorded information in their possession for 25 months after notice of action, on any application (including any notice of adverse action taken) or incomplete application.

Business Credit

All business credit, that is, credit extended for business, commercial or agricultural purposes, is subject to the general rule under Regulation B that a creditor shall not discriminate against any applicant on any prohibited basis with respect to any aspect of a credit transaction. Financial institutions are also subject to many of the other more specific requirements of Regulation B in connection with business credit. The following is a list of the provisions of the regulation that affect business credit:

- Information regarding marital status may always be requested in business credit, but information relating to sex may not.
- The provisions requiring a financial institution to determine whether accounts are shared with spouses in order to furnish credit information are not applicable to business credit.

- The financial institution must notify the applicant, orally or in writing, of action taken or of the incompleteness of the application. The financial institution must provide the written notifications relating to adverse action in business credit only when the applicant requests, in writing, the reasons for any adverse action. The customer's request must come within 30 days after the financial institution's notification to the customer of the adverse action.

- Any records relating to an application for business credit must be retained for 25 months after notice of action taken or of incompleteness only when the applicant requests, in writing, that such records be retained, within 90 days after adverse action is taken.

- The provisions regarding a spouse's signature are applicable to business credit. Specifically, financial institutions generally may not require that spouses of principals become liable for or guarantee the debt (unless the spouse is also a principal in the business).

Women's Business Ownership Act of 1988

Beginning April 1, 1990, new rules apply to business credit under Regulation B. The rules implement amendments to the ECOA contained in the Women's Business Ownership Act of 1988, and address concerns about access to credit for businesses owned by women and minorities. Lawmakers believed that while financing is a problem for most small businesses, women business owners may experience greater difficulties because of sex discrimination.

The new requirements are intended to inform business applicants of their rights under the law and to provide records so that supervisory agencies can better discern whether unlawful discrimination is taking place.

Rules Based on Applicant's Revenue Size

The legislative history indicated that the Federal Reserve Board should impose the new requirements to ensure that ECOA rights were available to the owners of small business entities. The Board's regulations implement the law and set these two basic requirements when the business earns $1 million or less in annual revenues (and different rules, described below, for larger entities):

1. the lender must give a notice disclosing the applicant's right to a written statement of reasons if credit is denied.

2. the lender must keep records on loan applications whether the loan was granted or denied - for one year (counting the date that the applicant was notified of the lender's credit decision).

Compliance Procedures for Lenders

The first step toward compliance is to decide on the approach that best fits in with the institution's business lending operations, taking such matters as business volume into account.

Adopt consumer rules for all transactions

The new rules for business credit are very close to the rules in applicable to consumer credit transactions. An institution could apply the consumer rules and be in full compliance with the act and regulation.

- the institution would inform the applicant orally when a loan is granted, but would have to put it in writing when the credit is denied.

- when credit is denied, the institution would have the choice of automatically giving the reasons for denial in writing or giving notice of the applicant's right to a written statement of reasons, also in writing, and giving the actual statement only when asked.

- the institution would retain records for 25 months, as in consumer credit. Or, the institution could opt to follow the consumer rules on notices and the business credit rule of 12 months on recordkeeping.

Use one set of rules for all business transactions

The institution could apply the same rules across the board - that is, those that govern when a business applicant's revenues are $1 million or under - in all business transactions regardless of revenue size, as follows:

- the institution would tell the applicant of the credit decision orally, whether an application is granted or denied.
- it would have two options for giving notice of the applicant's right to a written statement of reasons. Option 1 would involve giving the applicant who is denied credit either the reasons in writing or notice of the right to a written statement of reasons (also in writing). In either case, this action must be taken within 30 days of receiving a completed application, the same as in consumer transactions. Option 2 involves giving a notice to all applicants of the right to a written statement of reasons in the event of a denial. It can be given during the application state, rather than after credit is denied, but must be in a form the applicant can keep (such as on a document given to the applicant, or on a separate sheet).
- records from business applications must be retained for one year; the institution could segregate loan files based on the revenue size of the business, keeping records for one year if revenues were $1 million or less.

Follow two sets of rules for business credit

The institution could adopt the rules above, as applicable, and use the following procedures when revenues exceed $1 million:

- inform the applicant of the credit decision, orally or in writing, within a reasonable time of receiving a complete application. (The Board has said that 30 days is always reasonable). There is no required disclosure of the applicant's right to a written statement, although the applicant is in fact entitled to such a statement on request.
- the institution must keep records of an application for at least 60 days after notifying the applicant of the credit decision. After that, records may be discarded unless the applicant asks for a written statement of the reasons for denial, or asks that records be kept for the one-year period.

Examination Objectives

To determine that the institution does not discriminate in the granting of credit on any of the bases prohibited by the ECOA and Regulation B.

To determine that the institution has established procedures to ensure that it is in compliance with the ECOA and Regulation B.

Examination Procedures

1. Determine whether the institution has established policies and procedures with regard to Regulation B.
2. Determine that all applicable forms (i.e., applications and adverse action notifications) are in compliance with the regulation.
3. Determine that the institution is in compliance with the adverse action notification requirements.
4. Determine that the institution observes the regulation's restrictions on obtaining spousal signatures on consumer and business credit.
5. Determine that credit histories are properly maintained and reported.
6. Determine that appropriate records are maintained as required by the regulation.

References

Laws:

15 USC 1691 et seq.	Equal Credit Opportunity Act
P.L. No. 100-533, 102 Stat. 2680	Women's Business Ownership Act of 1988

Regulations

Federal Reserve Board Regulations (12 CFR):

Part 202	Regulation B

Office of Thrift Supervision Regulations (12 CFR):

Part 528	Nondiscrimination Requirements

Memorandum, Resolutions, and Opinions

Memoranda:

SP 15	May 25, 1978 - Violation of Parts 528 and 531.8 of the Bank System Regulations.
SP 65	February 24, 1986 - Nondiscrimination regulation Section 528.6; CRA regulation Section 563e.

Opinions:

Office of General Counsel Opinion - March 21, 1974	Published in the Supervisory Service as Comment-Ruling 11,039. OTS regulations: Applicability of Part 528 to practices of 'Redlining' by institutions. Also addresses the issue of 'discrimination in effect' and the burden of proof placed on a member institution. (See annotation .2 to 12 CFR 528.2a)

Other References

FFIEC Pamphlet	Home Mortgage Lending and Equal Treatment

Introduction

The Fair Housing Act (FHA) is Title VIII of the Civil Rights Act of 1968, as amended (42 U.S.C. 3601 et seq). It regulates many practices relating to housing. Perhaps most critically relevant to financial institutions, the FHA makes it unlawful for any lender to discriminate in its “residential real estate-related” activities against any person because of race, color, religion, sex, handicap, familial status, or national origin. The FHA was most recently amended by the Fair Housing Amendments Act of 1988. These amendments, effective March 12, 1989, were enacted to establish an administrative enforcement mechanism under the U.S. Department of Housing and Urban Development (HUD), to stiffen penalties for noncompliance, and to add handicap and familial status (having children under the age of 18) as prohibited bases for covered housing decisions.

The purpose of this Handbook Section is to highlight the key provisions of the FHA. Recognizing that primary enforcement authority for compliance with the FHA is vested in HUD, it is still important for examiners to understand the key requirements of this statute as they relate to thrift institutions. Many of the provisions of the FHA and HUD's implementing regulations are reflected in our own nondiscrimination regulations at 12 CFR Part 528. These regulations and the examination procedures related to them are discussed in Handbook Section 200: Fair Lending-General.

Note: The Equal Credit Opportunity Act of 1974 (ECOA), as amended (see Handbook Section 205), prohibits discrimination with respect to any aspect of a credit transaction on the basis of sex, race, color, religion, national origin, marital status, age, receipt of public assistance, or the exercise, in good faith, of rights granted by the Consumer Credit Protection Act. Anyone in the business of providing loans for housing is subject to both statutes and is, therefore, prohibited from discriminating on any of these bases. There are a few situations in which the FHA and ECOA diverge somewhat. These will be mentioned at appropriate points in this section.

Summary of Key Sections of the Fair Housing Act

(*Note:* Section references apply to the Act as amended in 1988.)

Section 801 states that, “It is the policy of the United States to provide, within constitutional limitations, for fair housing throughout the United States.”

With regard to prohibited practices, FHA section 805, which applies to the financing, selling, brokering, and appraising of housing, and FHA section 804, which addresses sales, rentals, and related activities, are of primary relevance to the daily operations of most financial institutions.

Section 805 makes it unlawful for a financial institution to discriminate against any person in making available, or in setting the terms and conditions of, a residential real estate-related transaction because of race, color, religion, sex, handicap, familial status or national origin. Section 805 defines residential real estate-related transaction” to mean (1) the making or purchasing of loans or providing other financial assistance (a) for purchasing, constructing, improving, repairing, or maintaining a dwelling, or (b) secured by residential real estate, and (2) any selling, brokering, or appraising of residential real property.

Section 804 prohibits the following with respect to the sale or rental of housing, if based on race, color, religion, sex, or national origin, or because of a handicap of any applicant, occupant or potential occupant, or associated person:

- Refusing to sell or rent housing after a bona de offer is made, or refusing to negotiate to sell or rent, or otherwise making unavailable or denying, a dwelling.
- Discriminating with respect to terms, conditions, or privileges of sale or rental, or with respect to the provision of services or facilities in connection with the dwelling.

- Making any oral or written statement or advertisement with respect to a sale or rental that indicates preference, limitation, or discrimination based on a prohibited consideration.
- Representing falsely that a dwelling is not available.
- Inducing or attempting to induce for pro t the sale or rental of property through representations regarding the entry or prospective entry into the neighborhood of a certain person or persons.

FHA section 804 is clearly applicable to an institution's managing and marketing of residential real estate owned. Section 804 has a broader application, however, despite reference in its caption to only sales and rentals. This section makes it unlawful not only to refuse to negotiate or complete a sale or rental, but also to “otherwise make unavailable or deny” a dwelling on a prohibited basis. In *United States v. City of Parma*, 374 F. Supp. 730 (N.D. Ohio, 1974), a case dealing with the city's zoning practices, the Court characterized this language as being “as broad as Congress could have made it” and as “catch-all phraseology which may not be easily discounted or de-emphasized.”

In the case of *Laufman v. Oakley Building and Loan Company*, 408 F. Supp. 489 (S.D. Ohio, 1976), the Court specifically held that, although section 804 generally applies to sales and rentals and section 805 to extensions of financial assistance in connection with housing, transactions involving sales or rentals and loans or other financial assistance in connection with housing are subject to both. The Court went on to say that the same conduct may be prohibited by either or both. Consequently, a financial institution's practices in the area of housing finance should be examined in a general way to ensure that they do not “otherwise make unavailable or deny” housing, regardless of the fact that no specific act or practice may violate any explicitly named prohibition of the FHA.

FHA section 810 provides that a person who claims to have been discriminated against may, within one year after the alleged discriminatory housing practice has occurred or terminated, file a written complaint with HUD. The Secretary of HUD may also initiate complaints directly. HUD will investigate either type of complaint, generally determining within 100 days whether to le a charge or dismiss the complaint. If a charge is filed, HUD will attempt to resolve the grievance between the complainant and the respondent(s) by conciliation.

A conciliation agreement may provide for binding arbitration, which may award appropriate relief, including monetary relief. Each conciliation agreement is made public unless the complainant and the respondent agree and the Secretary determines that disclosure is not required. If the Secretary concludes at any time following the filing of a complaint that prompt judicial action is necessary, the Secretary may authorize civil action for appropriate temporary or preliminary relief. Upon receipt of such authorization, the Attorney General of the United States shall promptly commence such action.

FHA sections 803 and 807 establish conditions under which specified transactions qualify to be exempted from FHA requirements. For example, special allowances are made for owner/occupant sales and rentals that meet stated (very limiting) criteria. Also, certain “housing for older persons” and housing operated by and for religious organizations or private clubs may be exempt from some or all provisions. As a practical matter, financial institutions will generally not qualify for any exemption from the FHA, although certain of an institution's borrowers may so qualify.

FHA section 811 provides that the Secretary of HUD may issue subpoenas and order discovery in aid of investigations of complaints filed for discriminatory housing practices. Under this section, any person who willfully fails or neglects to attend and testify or to answer any lawful inquiry, or to produce records, documents, or other evidence shall be fined not more than $100,000 or imprisoned not more than one year, or both. These penalties are also applicable to any person who makes any false entry or statement of fact and for any person who willfully mutilates, alters, or by any other means falsifies any documentary evidence.

Section 812 provides that when a complaint is led under Section 810, the person on whose behalf a complaint has been led may elect the forum in which the complaint will be processed. The options include (a) a proceeding before an administrative law judge (ALJ) with right to appeal to a federal appeals court, or (b) a trial in a federal district court. The election must be made not later than 20 days after filing of the charge. If the administrative hearing is elected and discriminatory conduct is found, the ALJ is authorized to issue an order for relief as may be appropriate, including actual damages and injunctive or other equitable relief and civil penalties. The ALJ's order may be reviewed by the Secretary within 30 days after issuance; otherwise the order becomes final. If a jury trial is elected, the complainant will be represented by an attorney from the United States Department of Justice. In these cases, the relief that may be granted includes permanent or temporary injunction, restraining order, or other relief, including monetary damages and civil penalties.

FHA section 813 provides that aggrieved persons may commence a civil action in an appropriate United States district court or State court within two years after the occurrence or the termination of an alleged discriminatory housing practice, or the breach of a conciliation agreement. An aggrieved person may commence civil action under this section whether or not a complaint has been led under Section 810. The court may appoint an attorney for the plaintiff. If it finds that a discriminatory practice has occurred or is about to occur, the court may grant relief as it deems appropriate, including any permanent or temporary injunction, temporary restraining order, or other order enjoining the defendant from engaging in such practice. The court may also award to the plaintiff actual and punitive damages.

FHA section 814 provides that the Attorney General may commence civil action in United States district court against any person or persons when reasonable cause exists to believe such person(s) are engaged in a pattern or practice of resistance to the full enjoyment of any of the rights granted by the FHA. The Attorney General may also commence action when an alleged discriminatory housing practice or a breach of a conciliation agreement has been referred by the Secretary of HUD.

FHA section 814A establishes a privilege for the report of results of a self-test to determine the level of an institution’s compliance with the FHA. This parallels a similar provision in the ECOA. HUD regulations implementing this provision match-up with the Federal Reserve Board’s implementing regulations contained in Regulation B at §202.15. (See Handbook Section 205).

FHA section 815 provides that the Secretary of HUD may make rules necessary to carry out the FHA. Under this mandate, HUD has issued amended rules under Title 24 C.F.R. Part 100 to implement and enforce the provisions of the Fair Housing Act. The text of these regulations, which became effective March 12, 1989, was distributed with Thrift Bulletin No. 19 (March 10, 1989).

FHA section 818 states that it is unlawful to coerce, intimidate, threaten, or interfere with any person in the exercise or enjoyment of any right granted or protected by sections 803, 804, 805, or 806 of the Act, including the right to aid or encourage other persons to exercise such rights.

Unlawful Discriminatory Lending Practices under the FHA

Like most other civil rights statutes, the Fair Housing Act was broadly written by Congress, and has been accorded “a sweep as broad as its language” in the courts. The 1988 amendments, although as yet untested in the courts as to specific cases, are expected to further reinforce the breadth of protection courts have accorded under the FHA. Even prior to the 1988 amendments, a wide variety of lending practices have been found illegal under the FHA, including some that are not specifically mentioned in the Act itself, but which have been determined to be illegal because they violate requirements and prohibitions that are implicit in its language. What follows are discussions of some prohibited practices, and where relevant, discussions of the cases in which courts have determined them to be prohibited.

1. Redlining on a racial basis has been held by the courts to be prohibited by the FHA, Laufman v. Oakley Building and Loan Company. One may reasonably infer that redlining on any other discriminatory basis proscribed in the

FHA would draw the same conclusion. Redlining is the practice of denying loans for housing in certain neighborhoods even though the individual applicant may be otherwise eligible for credit. The term “redlining” refers to the presumed practice of mortgage lenders of drawing red lines around portions of a map to indicate disfavored neighborhoods. The FHA does not prohibit “redlining” on grounds other than the prohibited factors set forth in the statute. However, excluding any geographical area from lending activity, even on seemingly sound economic grounds (e.g., the area lies along an active geologic fault line) could have discriminatory effects disproportionately adverse to a protected segment of the population and, therefore, be construed as a possible violation of the FHA. The burden in such cases is on the lender to substantiate that the exclusion is based solely on valid economic considerations.

2. Making excessively low appraisals in relation to purchase prices, based on prohibited considerations, is closely akin to redlining. This practice, which forces minority loan applicants to make larger downpayments, was held, in connection with a court-approved settlement, to violate FHA sections 804 and 818 (formerly 817) in a case brought by the Justice Department against the American Institute of Real Estate Appraisers, US v. AIREA. This decision's logic would apply to financial institutions that lend on the basis of such appraisals, as well.

3. The use of arbitrary, subjective, and non-reviewable rental criteria leading to an otherwise unexplained racial (or sexual, religious, etc.) imbalance in clientele was found to be illegal under section 804 in the case of US v. Youritan Const. Co., 370 F. Supp. 643 (N.D. Cal., 1973). In Youritan, the resident manager had instructed the rental agents to use differing procedures when approached by a black applicant than when approached by a white applicant. For example, white applicants were told that no credit check was necessary, whereas black applicants were told a lengthy one would be necessary. White applicants were told that there were vacancies when black applicants were told there were none. The court's rationale would clearly be applicable to lenders who use such standards in their housing lending, as well.

4. Creation and exploitation of a racially exclusive image, even where there may be little concurrent evidence of a discriminatory policy put into practice against any given individual applicant, has been repeatedly found to be illegal in the employment context. It was also held to violate the Fair Housing Act in US v. Real Estate Development Corp., 347 F. Supp. 776 (N.D. Miss, 1972). One indication of the existence of such an image, and possibly of its exploitation by management, might be the absence or clearly less than conspicuous display of the required Equal Housing Lender poster (12 CFR 528.5) in the lobby of each office.

   Using advertising that tends to select applicants of a particular race, etc., is another way in which a housing lender might exploit an exclusive image. The use of only white human models in advertisements, suggesting that white applicants are preferred, is an example of this type of advertising. Another is use of media that caters only to selected segments of the population, if such selectivity is not offset by other advertising efforts. Selective advertising practices are explicitly noted by the revised HUD fair housing regulation at 24 CFR 109.25 as potentially discriminatory either by intent or in effect, and must be used by lenders with great care.

   Section 804(c) makes it unlawful to make or print a statement or advertisement with respect to the sale or rental of a dwelling indicating any preference or limitation based on a prohibited characteristic. In Holmgren v. Little Village Community Reporter, 342 F. Supp. 512 (N.D. Ill., 1971) the court applied this prohibition to newspaper advertisements soliciting tenants and home buyers who spoke certain languages.

   The creation of an exclusive image which tends to discourage certain otherwise qualified applicants may also be considered a violation of the ECOA, specifically section 202.5(a) with regard to discouraging applications on a prohibited basis. Read together, the FHA and ECOA produce a strong statutory prohibition against prescreening or otherwise discouraging applicants in any manner, beginning with the content of advertising, that may be construed to have a discriminatory impact. Consequently, a financial institution would be well advised to ensure that its advertising and marketing policies do not have the effect, even inadvertently, of prescreening potential applicants for credit on prohibited bases.

5. Discriminatory acts which have a negative impact on non-minorities, such as white persons, are illegal, and such persons have standing to sue, the Supreme Court decided in Trafficante v. Metropolitan Life Ins. Co., 409 US 205 (1972). Two tenants of an apartment complex, one white and one black, were able to bring suit under section 810(a) for loss of the social and business advantages they suffered because of the owner's policy of discriminating against nonwhites. They also claimed that they were "stigmatized" by policies which made the complex in which they lived a "white ghetto."

   Additionally, a white plaintiff who was refused a mortgage on standard terms because the property was in an "integrated" neighborhood was permitted to bring suit under FHA sections 804 and 818 (formerly 817) in Harrision v. Heinzeroth Mtg. Co., 430 F. Supp. 893 (N.D. Ohio 1977).

6. The use of excessively burdensome qualification standards for the purpose, or with the effect, of denying housing to minority applicants, is illegal under FHA section 804 as the court held in US v. Youritan Const. Co., 370 F. Supp. 643 (N.D. Cal., 1973). In Youritan, for example, the rental agents emphasized the security deposit to black applicants, but not to whites, and required credit checks for black applicants, but not for whites.

7. The imposition on minority loan applicants of more onerous interest rates, or other terms, conditions, or requirements, is explicitly prohibited under FHA section 805. The phrase "terms or conditions" as used in the FHA is very broad, and will cover many types of discriminatory practices. Constructing upon very similar language in section 804(b), for instance, the court in Williams v. Matthews Co., 499 F.2d 819(8th Cir., 1974), found it to be illegal for a developer to follow a policy of selling lots in a subdivision only to persons having construction contracts with "approved" builders. All the "approved" builders were white and none of them would break the segregation barrier by building a house for a black family in a white subdivision.

8. As a further development of the "terms or conditions" language of section 805, the *application of differing standards or procedures* in administering foreclosures, late charges, penalties, or reinstatements, or other collection procedures is also unlawful, as the court held in *Harper v. Union Savings Assoc*., P-H Section 15,203 (N.D. Ohio, 1977).

9. *Discrimination in the terms or availability of insurance* is a subject with respect to which the FHA and the ECOA may be seen to diverge somewhat. The ECOA does not prohibit a creditor who sells or participates in the sale of insurance from differentiating in the terms and availability of insurance on prohibited bases. Nor does it prohibit discrimination regarding the availability or terms of credit on the basis that insurance is unavailable, except when the insurance has been denied on the basis of age. However, when dealing with housing credit the result may be different.

   The Department of Justice has taken the position that the FHA is violated when insurance required for housing credit is denied, or made more difficult to obtain, on a basis prohibited by the FHA.

   This does not mean that a financial institution cannot require insurance, particularly casualty insurance, in connection with its mortgage loans. However, if the financial institution sells, or assists in obtaining, insurance, and the insurance is denied or made available on more onerous terms because of unlawful discrimination, or if the customer is adversely affected in the terms or availability of credit because insurance is unavailable, the financial institution has violated the FHA. If, on the other hand, the financial institution merely requires that the customer obtain insurance from an acceptable insurance company of the applicant's choice, it is probable that the institution is not liable for any discriminatory actions by the unaffiliated third party insurance provider.

10. *Racial steering*, or deliberately guiding potential purchasers to or away from certain areas because of race, is illegal and violates section 804. In *Zuch v. Hussey*, 394 F. Supp. 1028 (E.D. Mich., 1975), the Court said: “Unlawful steering or channeling of a prospective buyer is the use of a word or phrase or action…which is intended to influence the choice of a prospective property buyer on a racial basis…Where choice influencing factors such as race are not eliminated, freedom of choice in the purchase of real estate becomes a fantasy…. It is the freedom of choice for the purchaser which the Fair Housing Act protects. Accordingly, any action…which in any way impedes, delays, or discourages on a racial basis a prospective home buyer from purchasing housing is unlawful.”

11. *Other possible discriminatory lending practices* might include:

    - Racial notation or code on appraisal forms or loan forms (other than the information required by law to be retained for monitoring purposes).
    - Use of scripts by initial interview personnel that are designed to discourage applications.

12. The following are some of the situations that may be encountered which constitute *sex discrimination*, a prohibited consideration under FHA as well as ECOA:

    - Discounting or disregarding the income of a working wife or single woman.
    - Refusing to grant a loan, or granting a loan on different terms and conditions, because of sex.
    - Requiring more or different information from a female applicant than from a male applicant (for example, birth control arrangements or a family plan).
    - Subjecting a female applicant to a different or more extensive credit check than that which is usually required for male applicants.
    - Refusing to include alimony or child support as viable income where evidence is provided of a history of consistent prior payment and indicates that payments are likely to continue.
    - Basing any aspect of a lending decision on general presumptions about women (for example, women of childbearing age are poor risks).
    - Treating single working parents differently from married working parents
    - Requiring a cosigner for female applicants, but not for male applicants.

It should be emphasized that financial institutions are not expected to make unsound real estate loans or render services on more favorable terms to applicants solely because of their status as members of a class that is protected by the FHA. What is intended by Congress is that loans and related services not be denied or made more onerous on the basis, even partially, of any applicant's status with regard to one of the prohibited characteristics: Race, color, religion, sex, handicap, familial status, or national origin. The taint of prohibited considerations must be removed completely from housing-related transactions. As the court in *Williams v. Matthews Co.*, 499 F.2d 819 (8th Cir., 1974), put it with respect to one such characteristic: “Race is an impermissible factor in real estate transactions under both [the Fair Housing and the 1870 Civil Rights Acts] and cannot be brushed aside [just] because it was neither the sole reason for discrimination nor the total factor of discrimination.”

Examination Objectives and Procedures

(See Section 200: Fair Lending-General)

References

Laws

42 USC 2000d et seq.	Civil Rights Act of 1964, Title VI Federally Assisted Programs
42 USC 3601 et seq.	Civil Rights Act of 1968, Title VIII Fair Housing Act (as amended thru 1988)
42 USC 3631	Civil Rights Act of 1968, Title IX Prevention of Intimidation in Fair Housing

Regulations

24 CFR 100	Department of Housing and Urban Development Fair Housing Regulation (especially Section 109, Advertising)
12 CFR 528	Office of Thrift Supervision, Department of the Treasury, Nondiscrimination Requirements Regulation

Memorandum, Bulletins, Resolutions, and Opinions

SP Memoranda:

SP 15	May 25, 1978-Violation of Parts 528 and 531.8 of the Bank System Regulations

Bulletins:

TB 19	Revised HUD Fair Housing Regulations
TB 25	Disparities in Mortgage Lending

Other References

FFIEC Pamphlet	Home Mortgage Lending and Equal Treatment

Introduction

The Home Mortgage Disclosure Act (HMDA) was enacted by the Congress in 1975 and is implemented by the Federal Reserve Board's Regulation C (12 CFR Part 203). The period of 1988 through 1992 saw substantial changes to HMDA. Especially significant were the amendments included in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). Coverage was expanded in the FIRREA amendments to include many independent non-depository mortgage lenders, in addition to the previously covered banks, savings associations, and credit unions. Coverage of independent mortgage bankers was further expanded effective January 1, 1993, with the implementation of amendments contained in the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA).

HMDA grew out of public concern over credit shortages in certain urban neighborhoods. The Congress believed that some financial institutions had contributed to the decline of some geographic areas by their failure to provide adequate home financing to qualified applicants on reasonable terms and conditions. Thus, one purpose of HMDA and Regulation C is to provide the public with information that will help show whether financial institutions are serving the housing credit needs of the neighborhoods and communities in which they are located. A second purpose is to aid public officials in distributing public investments to attract private investments to areas where they are needed. The FIRREA amendments of 1989 created a third purpose by introducing a fair-lending aspect to HMDA that requires the collection and disclosure of data about applicant and borrower characteristics as a way of identifying disparate lending patterns that need to be reviewed in conjunction with agency fair lending efforts.

Approved-FFIEC

As the name implies, HMDA is a disclosure law that relies upon public scrutiny for its effectiveness. It does not prohibit any specific activity of lenders, and it does not establish a quota system of mortgage loans to be made in any MSA or other geographic area (an MSA refers to a “metropolitan statistical area” or “primary metropolitan statistical area” as defined by the U.S. Office of Management and Budget).

Financial institutions must report data regarding loan originations, applications that do not result in an origination (for example denials and withdrawals), as well as information concerning loan purchases. HMDA also requires most lenders to report the race, gender, and gross annual income of mortgage applicants and borrowers. Additionally, lenders must identify the class of purchaser for mortgage loans that they sell, and most lenders have the option of indicating the reasons for their decisions not to grant credit. (National banks and those lenders regulated by the Office of Thrift Supervision must provide the reasons under agency regulations.)

Regulation C requires financial institutions to report lending data to their supervisory agencies on a loan-by-loan and application-by-application basis by way of a “register” reporting format. The supervisory agencies, through the Federal Financial Institutions Examination Council (FFIEC), compile this information in an individual disclosure statement for each financial institution and in aggregate reports for all covered financial institutions within each MSA. In addition, the FFIEC produces other aggregate reports that show lending patterns by median age of homes and by the central city or non-central city location of the property. These FFIEC disclosure statements and reports are available to the public at a central depository located in each MSA, and may also be obtained directly from the FFIEC. The individual FFIEC disclosure statements are also available at the respective financial institutions.

Applicability

The regulation covers two categories of financial institutions. The first category is a depository institution-a bank, savings association, or a credit union-that originated, in the preceding calendar year, a first-lien home purchase loan (including refinancing of such loans) on a one-to-four family dwelling if: (1) the institution is federally insured or regulated; (2) the loan is federally guaranteed, insured, or supplemented; or (3) the institution intended to sell the loan to the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation. The second category is a for-profit, non-depository mortgage lending institution. A non-depository mortgage lending institution is covered if, in the preceding calendar year, ten percent or more of its loan origination volume, measured in dollars, consisted of home purchase loans, including refinancings of such loans. For the purposes of this discussion and the examination procedures, the term “financial institution” will signify both a depository and non-depository institution; “depository institution” will signify “a bank, savings association, or credit union”; and “non- depository institution” will signify a “for-profit mortgage lending institution (other than a bank, savings association, or credit union).”

The definition of non-depository institution applies to majority-owned mortgage lending subsidiaries of depository institutions and, since 1990, to independent mortgage companies. Mortgage lending subsidiaries of bank holding companies, savings and loan holding companies, and savings and loan service corporations have been covered by HMDA since 1988. Mortgage lending subsidiaries are treated as distinct entities from their parents and must prepare separate reports to be filed with their parent's supervisory agency.

Though a financial institution may fall within one of these two categories, it is exempt from the regulation if it did not have a home or branch office in an MSA at the end of the previous calendar year. For depository institutions, a branch office is an office approved as a branch by a federal or state supervisory agency (excluding ATMs). A non-depository institution is considered to have a branch office in an MSA if it took applications for, originated, or purchased five or more home purchase or home improvement loans on properties located in that MSA in the previous calendar year.

Depository institutions also are exempt from HMDA if, at the end of the previous calendar year, they had $29 million or less in assets. The Economic Growth and Regulatory Paperwork Reduction Act of 1996 amended HMDA by increasing the HMDA reporting exemption based on asset size for depository institutions and providing that the asset exemption will be adjusted annually to reflect changes in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPIW). While the exemption from HMDA data collection in 1999 is $29 million, the exemption will be adjusted annually to reflect future changes in the CPIW. The Federal Reserve Board will publish the exemption amount in the Federal Register on an annual basis.

A non-depository institution is also exempt if its assets, when combined with those of any parent institution, are less than $10 million and it originated fewer than 100 home purchase loans (including refinancing of such loans) in the preceding calendar year.

Finally, the Federal Reserve Board may exempt from Regulation C state-chartered or state-licensed financial institutions if they are covered by a substantially similar state law that contains adequate provision for enforcement by the state. As of January 1, 1999, no exemptions were in effect.

Compilation of Loan Data

For each calendar year, a financial institution must report data regarding its originations and purchases of home purchase and home improvement loans. Loans secured by real estate but made for purposes other than home purchase, home improvement, or refinancing are not reported. Data must also be given for loan applications that did not result in originations. Specifically, reporting is required for loan denials, withdrawn applications, applications that are approved but not accepted, and application files that are closed for incompleteness.

A home purchase loan is defined by Regulation C as a loan secured by a dwelling and made for the purpose of purchasing that (or another) dwelling. A dwelling is a residential structure that may or may not be attached to real property, and covers one-to-four family dwellings, including individual condominium or cooperative units and mobile or manufactured homes, as well as multifamily dwellings housing five or more families.

A home improvement loan is defined as one that is for the purpose of repairing, rehabilitating, remodeling, or improving a dwelling or the real property on which it is located, and that is classified by the financial institution as a home improvement loan. Home improvement loans may be secured or unsecured.

Financial institutions may, at their option, report home equity credit lines as home improvement or home purchase loans in the year that the line is established if a part of the line is identified by the consumer at the time of application (or when the account is opened) as being for home improvement or home purchase purposes. Only that portion of the line which the borrower or applicant indicates will be for home improvement or home purchase purposes is reported.

The regulation requires financial institutions to report data so as to identify the following general loan types: conventional, FHA insured, VA guaranteed, and Farmers Home Administration (FmHA) insured loans. In addition, financial institutions are required to identify the purpose (home purchase, home improvement, refinancing, or multi-family) and the amount of the loan or loan application, and whether the property relating to the loan or loan application is to be owner-occupied as a principal dwelling.

Certain geographic location information must be reported by financial institutions for loans on, and applications for, properties in any MSA where they have a home or branch office. This geographic information is optional for loans on properties located outside these MSAs or outside any MSA, except in the case of large financial institutions subject to additional requirements under the Community Reinvestment Act (CRA), as described below. The information consists of the MSA number, state and county codes, and the census tract number of the property to which the loan or loan application relates. Beginning with data for the 1992 calendar year, lenders have been required to use the census tract numbers from the U.S. Census Bureau's Census Tract/Street Index for 1990, the CPH-3 map series for the 1990 census, or equivalent 1990 census data from the Census Bureau or from a private publisher.

Institutions subject to the CRA and HMDA will collect and report geographic information for all loans and applications, not just for loans and applications relating to property in MSAs where the institution has a home or branch office. The requirement for geographic information also applies to property located outside any MSA. The data collection requirements go into effect for calendar year 1998, with institutions required to report the data in 1999. Under the CRA, banks or savings associations that have assets of $250 million or more, or are subsidiaries of a holding company with total banking and thrift assets of $1 billion or more must collect and report this data.

In addition, financial institutions must report data regarding the race or national origin, gender, and gross annual income of applicants for loans originated or applied for, but only optionally for loans purchased. This applicant information is optional for depository institutions that had $30 million or less in assets at the end of the previous calendar year. Different rules apply for institutions regulated by the FDIC and the OCC. Information regarding the race or national origin and the gender of the borrower or applicant must be requested by the lender (except for applications taken entirely by telephone). For all applications submitted in person, the lender is required to note the data on the basis of visual observation or surname if the applicant chooses not to provide the information. Regulation C contains a model form that can be used for the collection of data on race or national origin and gender. Alternatively, the form used to obtain monitoring information under §202.13 of the Federal Reserve Board's Regulation B (Equal Credit Opportunity) may be used.

If a financial institution originates or purchases a loan and then sells it in the same calendar year, it must report the type of entity that purchased the loan. Except in the case of large secondary market purchasers such as Fannie Mae and Freddie Mac, the exact purchaser would not be identified. For example, a financial institution would indicate that it had sold a loan to a bank, without identifying the particular bank. Finally, some financial institutions may, at their option, report the reasons for denying a loan application. National banks and those lenders regulated by the Office of Thrift Supervision are required to provide this information.

A financial institution should not report loan data for:

- loans originated or purchased by the financial institution acting as trustee or in some other fiduciary capacity;
- loans on unimproved land;
- construction or bridge loans and other temporary financing (but construction-permanent loans must be reported);
- the purchase of an interest in a pool of loans (such as mortgage-participation certificates);
- the purchase of mortgage loan servicing rights, or
- loans secured by real estate, but made for purposes other than home purchase, home improvement, or refinancing.

Disclosure and Reporting

Financial institutions are required to record data regarding each application for, and each origination and purchase of, home purchase loans and home improvement loans (including refinancings) on a Loan/Application Register, also known as the HMDA-LAR. Transactions are to be reported for the year in which a final action was taken on the application. If a loan application is pending at the end of the calendar year, it will be reported on the HMDA-LAR for the following year, when the final disposition is made. Loans originated or purchased during the calendar year must be reported even if they subsequently have been sold within the same year.

The HMDA-LAR is accompanied by a listing of codes to be used for each entry on the form. Detailed instructions and guidance on the requirements for the register are contained in Appendix A to Regulation C. Additional information is available in the FFIEC publication, “A Guide to HMDA Reporting-Getting it Right,” updated in March 1998 as well as the Regulation C Staff Commentary dated in December 1998, effective January 1, 1999.

Financial institutions have flexibility in determining how to maintain the HMDA-LAR since the entries need not be grouped in any prescribed fashion. For example, a financial institution could record home purchase loans on one HMDA-LAR and home improvement loans on another; alternatively, both types of loans could be reported on one register. Similarly, separate registers may be kept at each branch office, or a single register could be maintained at a centralized location for the entire financial institution.

Financial institutions should collect and maintain the required information on their HMDA-LARs on an ongoing basis. As of January 1, 1996, financial institutions are required to update their HMDA-LAR quarterly.

For each calendar year, a financial institution must submit to its supervisory agency its HMDA-LAR, accompanied by a Transmittal Sheet. As of January 1, 1996, unless it has 25 or fewer reportable transactions, a financial institution is required to submit its data in automated form (e.g. diskette, magnetic tape, etc.). This will streamline the reporting process and reduce the potential of key-entry errors. For registers submitted in paper form, two copies must be mailed to the financial institution's supervisory agency. For both automated and hard-copy submissions, the layout of the register that is used must conform exactly to that of the HMDA-LAR form published by the Federal Reserve Board as part of Appendix A to Regulation C.

The HMDA-LAR must be submitted to the financial institution's supervisory agency by March 1 following the calendar year covered by the data. The FFIEC will then produce a disclosure statement for each financial institution, cross-tabulating the individual loan data in various groupings. These individual disclosure statements will be mailed to the financial institutions.

Amendments to HMDA affecting the disclosure of data were included in the Housing and Community Development Act of 1992. A financial institution must make its disclosure statement available to the public at its home office within three business days of receipt from the FFIEC. Within ten business days of receipt, an institution must make its disclosure statement available to the public in at least one branch office in each additional MSA where it has offices.

Also, a financial institution must make its loan application register available to the public after modifying it to delete the following fields: application or loan number, date application received, and date of action taken. These modifications are required to protect the privacy interests of applicants and borrowers. The modified HMDA-LARs for the previous calendar year must be publicly available by March 31 for requests received on or before March 1, and within 30 days for requests received after March 1; this requirement applies to data for 1992 and subsequent calendar years.

A complete copy of a financial institution's disclosure statement and modified HMDA-LAR must be made available at the financial institution's home office; the disclosure statement and modified register at branch offices need only contain data for the MSA in which the branch is located.

The FFIEC also produces aggregate tables to illustrate the lending activity of all covered financial institutions with branches in each MSA. The FFIEC sends the individual disclosure statements and the aggregate tables to a central depository, such as a public library, in each MSA. A list of depositories is available from the FFIEC.

A financial institution must retain its full HMDA-LAR for at least three years for examination purposes. It must also be prepared to make the modified HMDA-LAR available for three years and each FFIEC disclosure statement available for five years. Financial institutions may impose reasonable fees for costs incurred in providing or reproducing the data for public release.

Finally, financial institutions must post a notice at their home office, and at each branch in an MSA, to advise the public of the availability of its HMDA data.

Enforcement

As set forth in Section 305 of HMDA, compliance with the act and regulation is enforced by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of Thrift Supervision, and the U.S. Department of Housing and Urban Development. Administrative sanctions, including civil money penalties, may be imposed by these supervisory agencies.

An error in compiling or recording loan data is not a violation of the act or the regulation if it was unintentional and occurred despite the maintenance of procedures reasonably adopted to avoid such errors.

Examination Objectives

1. To determine if the financial institution complies with the reporting and disclosure requirements of the act and regulation.
2. To determine the adequacy of the financial institution's policies, procedures, practices and internal controls to ensure compliance with the act and regulation.
3. To determine the accuracy and timeliness of the financial institution's submitted HMDA-LAR.

Examination Procedures

Applicability

Depository Institutions

1. Determine whether the depository institution meets the criteria below. If all criteria (1.a.-1.d.) are met, then the depository institution is subject to the requirements of HMDA and Regulation C.

   a. The depository institution originated in the preceding calendar year at least one home purchase loan or refinancing of a home purchase loan secured by a first lien on a one-to-four family dwelling [§203.2(e)(1)]; and

   b. The depository institution:

   - is a federally insured or regulated institution [§203.2(e)(1)(i)]; or
   - originated a mortgage loan (reference procedure 1.a.) that was insured, guaranteed, or supplemented by a federal agency [§203.2(e)(1)(ii)]; or
   - originated a mortgage loan (reference procedure 1.a.) intending to sell it to FNMA or FHLMC [§203.2(e)(1)(iii)]; and

   c. The depository institution had either a home or a branch office in an MSA on December 31 of the preceding calendar year [§203.3(a)(1)(i)];

   d. The depository institution had assets at or below the asset threshold established by the Federal Reserve Board.

Note: The dollar threshold amount can vary each year depending on the year to year changes in the CPIW. For 1999, the asset threshold is $29 million as of December 31, 1998. [§203.3(a)(1)(ii)].

Non-depository Institutions

2. Determine whether the depository institution has a majority- owned mortgage subsidiary that meets the criteria below. If all criteria 2.a.-2.c.) are met, then the subsidiary is subject to the requirements of HMDA and Regulation C.

   a. The majority-owned mortgage subsidiary is a for-profit institution and, in the preceding calendar year, had home purchase loan originations, including refinancings of home purchase loans, equal to or exceeding 10 percent of its total loan originations measured in dollars [§203.2(e)(2)]; and

   b. The majority-owned mortgage subsidiary either:

   - had a home or branch office in an MSA as of December 31 of the previous year [§203.3(a)(2)(i)], or
   - received applications for, originated, or purchased five or more home purchase or home improvement loans on property located in an MSA in the preceding calendar year [§203.2(c)(2)]; and

   c. The majority-owned mortgage subsidiary either:

   - had total assets (when combined with the assets of the parent corporation) exceeding $10 million on the previous December 31, or
   - originated 100 or more home purchase loans, including refinancings of home purchase loans, in the preceding calendar year [§203.3(a)(2)(ii)].

If HMDA and Regulation C are applicable, then the following examination procedures should be performed separately for the depository institution and any of its majority-owned mortgage subsidiaries. A separate checklist should be completed for each institution subject to HMDA and Regulation C.

3. Determine whether there were any mergers or acquisitions since January 1 of the preceding calendar year

   a. Determine whether all required HMDA data for the acquired financial institutions were reported separately or in consolidation. Examination procedures that follow concerning accuracy and disclosure also apply to an acquired financial institution's data, even if separately reported.

Compilation of Loan Data

4. Determine, through a review of written policies, internal controls, the HMDA Loan Application Register (HMDA-LAR), and discussions with management, whether the financial institution has compiled home mortgage disclosure information in accordance with §203.4(a-d).

   a. Determine how the financial institution ensures that the home mortgage disclosure information is properly compiled and disclosed. Consider:

      - Whether the financial institution has assigned one of its officers responsibility for oversight.
      - Whether the Board of Directors has established an independent review of the policies, procedures, and HMDA data to ensure compliance and accuracy, and is advised each year of the accuracy and timeliness of the financial institution's data submissions.
      - Whether the financial institution performs a self-analysis of the accuracy of the HMDA data, and its timeliness, and whether the Board of Directors is informed of the results of the analysis. Obtain a detailed description of the analysis performed.
      - Whether the financial institution performs HMDA-LAR volume analysis from year-to-year to detect increases or decreases in activity for possible omissions of data.
      - Whether the financial institution maintains documentation for those loans it packages and sells to other institutions.
      - Whether the HMDA-LAR is updated within 30 days after the end of each calendar quarter beginning January 1, 1996.

   b. Determine how management ensures that affected financial institution personnel are aware of the requirements of the Act. Consider:

      - Whether the individuals who have been assigned responsibility for data-entry receive appropriate training in the completion of the HMDA-LAR and receive copies of all HMDA instructional materials from the FFIEC and the appropriate supervisory agency in a timely manner.
      - Whether these individuals have been provided copies of Regulation C, Instructions for Completion of the HMDA-LAR (Appendix A), the Staff Commentary to Regulation C, and the FFIEC's Guide to HMDA Reporting in a timely manner.
      - Whether these individuals know whom to contact, at the financial institution or their supervisory agency, if they have questions not answered by the written materials.
      - Whether the financial institution's loan officers (including loan officers in the commercial loan department who may handle loan applications for multi-family or mixed-use properties) are informed of the reporting requirements necessary to assemble the information.
      - Whether the financial institution's loan officers are familiar with the disclosure statements that will be produced from the data and cognizant of the ramifications for the financial institution if the data are wrong.

- Whether appropriate documentation of the information that has been entered on the HMDA-LAR is maintained.
- Whether data are collected at various branches, and if so, whether the appropriate personnel are sufficiently trained to ensure that all branches are reporting data under the same guidelines.
- Whether a numbering system is in place to assign unique identification numbers in codes to loan files.
- Whether the depository institution has some mechanism of internal controls to ensure that the data are captured accurately and consistently.
- The type of controls that have been established to ensure that separation of duties exists (e.g. data entry, review, oversight, approval).

c. Determine what procedures the institution has put in place to comply with the requirement to submit data in machine-readable form and whether the institution has some mechanism in place to ensure the accuracy of the data that are submitted in machine-readable form.

d. Determine if policies, procedures and training are adequate, on an ongoing basis, to ensure compliance with the Home Mortgage Disclosure Act.

5. Verify that the financial institution accurately compiled home mortgage disclosure information in the prescribed categories by testing a sample of loans and applications.

   The review of the HMDA-LAR for already-submitted data should include a sample of the applications represented on the HMDA-LAR to verify the accuracy of each entry. A sample of the current year's data should also be reviewed. The samples may comprise:

   - Approved and denied transactions subject to HMDA that are sampled for Regulations B and Z
   - Housing-related purchased loans
   - Withdrawn housing related loan applications

Disclosure and Reporting

6. Determine whether the financial institution has satisfied the following reporting and disclosure requirements:

   a. The financial institution submitted its HMDA-LAR to the appropriate supervisory agency no later than March 1 following the calendar year for which the data are compiled and maintains the HMDA-LAR for at least three years thereafter. [§203.5(a)]

   Note: Financial institutions that report twenty- five or fewer entries on their HMDA-LAR may collect and report HMDA data in a paper form. Any financial institution opting to submit its data in such a manner must send two copies that are typed or computer printed. They must use the format of the HMDA-LAR, but need not use the form itself.

   b. The financial institution makes its FFIEC disclosure statement available to the public at its home office no later than three business days after receiving its statement from the FFIEC; and, makes the statement available to the public in at least one branch office (in each additional MSA where the financial institution has offices) within ten business days after receiving the disclosure statement from the FFIEC. [§203.5(b)]

   c. The financial institution's modified HMDA-LAR has been made available to the public by March 31 for requests received on or before March 1, and within 30 days for a request received after March 1. [§203.5(c)]

d. The financial institution has policies and procedures to ensure its modified HMDA-LAR and its disclosure statement are available to the public for three and five years, respectively. [§203.5(d)]

e. The financial institution has posted a general notice about the availability of its disclosure statement in the lobby of its home office and any physical branch offices located in an MSA. [§203.5(e)]

7. Determine whether an officer of the financial institution signed the HMDA-LAR transmittal sheet certifying the accuracy of the data contained in the register. (Appendix A.III.B)

   Note: If the HMDA-LAR was submitted in an automated format, this signature should be retained on file, at the institution.

8. Review the financial institution's last disclosure statement, HMDA-LAR, and any applicable correspondence from the regulatory agency, such as notices of noncompliance. Determine what errors occurred during the previous reporting period. If errors did occur, determine what steps the financial institution took to correct and/or prevent such errors in the future.

9. Determine if the financial institution has the necessary tools to compile the geographic information. [§ 203.4(a)(6) and Appendix A]

   a. Determine if the financial institution uses the U.S. Census Bureau's Census Tract/ Street Index for 1990, the Census Bureau's 1990 Census Tract Outline Maps, equivalent materials available from the Census Bureau or from a private publisher, or an automated geocoding system in order to obtain the proper census tract numbers.

   b. If the financial institution relies on outside assistance to obtain the census tract numbers (for example, private “geocoding” services or real estate appraisals), verify that adequate procedures are in place to ensure that the census tract numbers are obtained in instances where they are not provided by the outside source. For example, if the financial institution usually uses property appraisals to determine census tract numbers, how does it obtain this information if an appraisal is not received, such as in cases where a loan application is denied before an appraisal is made?

   c. Verify that the financial institution has taken steps to ensure that the provider of outside services is using the appropriate 1990 Census Bureau data.

   d. Verify that the financial institution uses current MSA definitions to determine the appropriate MSA numbers and boundaries. MSA definitions and numbers (and state and county codes) are available from the supervisory agency, the “FIPS PUB 8-5, Metropolitan Statistical Areas” (as updated periodically), or “A Guide to HMDA Reporting, Getting it Right.”

   e. For banks and savings associations not meeting the small bank definition under the CRA, verify that accurate data are also collected on the location of every property, not just located in the MSA(s) in which the institution has a home or branch office or outside any MSA.